

Do democratic transitions attract foreign investors and how fast?*

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Abstract

This paper investigates the evolution of foreign direct investment inflows (FDI) around democratic transitions, in a panel of 115 developing countries from 1970 to 2014, using an event-study method. We find that democratic transitions on average do not affect FDI inflows. We then focus on consolidated democratic transitions, defined as transitions that did not reverse during at least five years. We find that consolidated democratic transitions do increase FDI inflows, with the bulk of the improvement appearing ten years after the transition. Furthermore, when controlling for political risk, the effect of consolidated democratic transitions appears immediately after the transition, suggesting that higher political risk accompanying the early years of democratic transitions offsets their positive intrinsic effect on FDI. The results are robust to changing the set of control variables, to alternative codings of the variables capturing the transition, disaggregating political risk into several sub-components, and the exclusion of outliers. Moreover, local projections, propensity score matching, and IV estimates lend credence to a causal interpretation of the results.

Keywords: FDI, Democratic transitions, Institutions, Development.

JEL classification: E02, F21, O11.

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1. Introduction

In June 2015, in the aftermath of Tunisia’s democratic transition, the Tunisian government organized an investment forum entitled “Investing in Tunisia, start-up democracy” with the aim of attracting foreign investors.¹ One year before the Tunisian conference, the Thai premier, in power since a coup in May 2014, had declared to European investors: “We are not dictators”.² The belief that democracy attracts foreign investors therefore seems to be widely held by both democratic and undemocratic country leaders. Should it?

In fact, a survey of the empirical literature on the impact of democracy on foreign direct investment (FDI) reveals that the evidence is both scarce and contradictory. True, Rodrik (1996), Harms and Ursprung (2002), or Jensen (2003) observe that countries that are more democratic or guarantee more political and civil rights attract larger FDI inflows. However, Li and Resnick (2003), Li (2009), or Berden et al. (2014) observe the opposite. Oneal (1994), Alesina and Dollar (2000), or Büthe and Milner (2008) find no significant relationship. Table A1 in the appendix surveys the 30 papers where we could find estimates of the impact of democracy on FDI inflows. If thirteen of those papers observe that the relationship is positive, five find it to be negative, and six insignificant. The last six find that the relationship only appears in some periods or if some conditions are met.

The difficulty to observe the impact of democracy on FDI may come from two obstacles on which all the studies have so far stumbled. First, democracy is difficult to define, let alone to measure. While some, like Dahl (1971) or Alvarez et al. (1996), emphasize competition between candidates and participation of citizens, others, like Gastil (1990) highlight the respect of a series of liberties and rights. As a result, existing democracy indexes rest on different assumptions about the exact notion of democracy that should be measured, and how it should be measured, resulting in debates on the appropriateness of those indexes, such as Alvarez et al. (1996) or Cheibub et al. (2010). Unsurprisingly therefore, Casper and Tufis (2003) show that the choice of a democracy index can affect empirical results. In addition, assuming that existing indexes do measure the degree of democracy, the shape of their relation with the

¹ <http://unctad.org/en/pages/SGStatementDetails.aspx?OriginalVersionID=107> (consulted June 10th 2016).

² <http://www.reuters.com/article/2014/08/27/us-thailand-politics-prayuth-idUSKBN0GR12T20140827> (consulted June 10th 2016).

concept that they measure is unknown. By transitivity, even less is known of the shape of the relation of democracy with FDI flows.

The second difficulty comes from the interplay between democracy and political risk. The effect of political risk on FDI has been repeatedly documented, since the early work of Schneider and Frey (1985) (see e.g. Alfaro et al., 2008). At the same time, political risk may vary in a systematic way with the level of democracy. This may be particularly true around democratic transitions, because young democracies are subject to a risk of autocratic reversal while they consolidate, as argued by Olson (1993), Acemoglu and Robinson (2001), Svobik (2008), or Persson and Tabellini (2009). By overlooking political risk, the risk of reversal, and the timing of the effect of democracy on FDI flows, existing studies may therefore provide biased estimates of the true effect of democracy, as Li and Resnick (2003) and Li (2009) point out.

In this paper, we offer a novel approach to address those two difficulties. The approach consists in applying to FDI flows an event-study method. The method consists in identifying episodes of democratic transitions in a panel of countries, and observing the evolution of FDI flows around those transitions. The method was recently applied to growth by Rodrik and Wacziarg (2005), Papaioannou and Siourounis (2008), Persson and Tabellini (2006), and Acemoglu et al. (forthcoming), but we are to our knowledge the first to apply it to FDI. Applying it to a sample of 115 developing countries from 1970 to 2014, we can address three embedded questions: Do democratic transitions affect FDI flows? Is the effect due to democracy per se or to political risk? What is the timing of the effect?

Our approach offers a solution to the two difficulties that plagued previous studies of the impact of democracy on FDI. First, the approach circumvents the difficulty of measuring the degree of democracy, because it only requires to determine whether a democratic transition occurred in a given year. Second, the approach allows disentangling the effect of democracy from the effect of political risk in two ways. One way is to determine consolidated transitions, defined as transitions that lasted at least five years (Papaioannou and Siourounis, 2008). Using the two definitions of democratic transitions in turn allows observing how political uncertainty affects the estimated effect of transitions on FDI flows. The second way in which the approach allows disentangling the effect of democracy from the effect of political risk consists in directly controlling for the effect of a time varying measure of political risk. We do so using the International Country Risk Guide's political risk index (ICRG). Finally, a by-product of the

approach is to allow sketching the average time profile of FDI flows over successive periods around transitions.

We find that democratic transitions on average do not attract FDI, but that consolidated democratic transitions do. The effect of consolidated democratic transitions is robust to controlling for the effect of political risk measured by the ICRG index, implying that democratic transitions have an intrinsic positive effect on FDI inflows. The effect of consolidated democratic transitions materializes around ten years after the transition. When controlling for political risk, the effect of consolidated democratic transitions is observable immediately after the transition, suggesting that new democracies attract foreign investors, but that the political risk accompanying the early years of democratic transitions offsets their positive intrinsic effect on FDI.

To reach those conclusions, the paper is constructed as follows. Section 2 discusses the theoretical reasons why democracy and democratic transitions may impact FDI flows and on the timing of the effect. Section 3 describes in detail the event study method of the paper and the dataset to which it is applied. Section 4 reports baseline results. Section 5 displays series of robustness checks, while Section 6 focuses entirely on endogeneity issues. The final section concludes.

2. Being a democracy vs. becoming a democracy

Because we study the impact of democratic transitions, as opposed to democracy, we must distinguish the effect of the level of democracy from the effect of the transition to democracy. A rich literature exists on the impact of democracy on various economic variables. Almost all the studies compare these variables in democratic countries and non-democratic countries, in general, referred to as autocracies. For simplicity; we will, from now on, refer to democracy and autocracy as if they were dichotomous variables, despite the heterogeneity of the two groups of countries. More important for our purpose is the distinction between democratic transitions and democracy. In what follows, democracy refers to the extent to which a country democracy respects a series of liberties and rights (Gastil, 1990) and allows competition between candidates and participation of citizens (Dahl, 1971, or Alvarez et al. 1996). Democratic transitions refer to a change from autocracy to democracy.

2.1 The potential impact of democracy on FDI

Democracies and autocracies may affect FDI because they set different rights, duties, and policies. Moreover, because those rights, duties, and policies are not set once for all, democracies and autocracies may also differ in the risk that they represent for foreign investors. That distinction between the intrinsic effect of democracy and its effect on risk has been emphasized by Li and Resnick (2003). This section follows and elaborates upon their discussion.

The effect of democracy on rights, duties and policies

Democracy, unlike autocracy, guarantees a series of rights, in particular civil, political, and labor rights. A classic argument suggesting that democracy would attract less FDI than autocracies is that those rights would give more power to workers and therefore deter foreign investors. Harms and Ursprung (2002) refer to that argument, although they find no empirical support for it. By the same token, by giving more weight to workers, democracy may drive wages up, as observed by Rodrik (1999), deterring foreign investors seeking cheap labor.

Secondly, democracies may also differ from autocracies in their policies towards FDI. O'Donnell (1978, 1988) argues that multinational firms take advantage of a presumed affinity with autocrats, because the latter can reap personal benefits from foreign investment. As autocrats also face fewer constraints than democratic governments, they can pursue their self-interest and offer more generous incentives to foreign investors, such as tax exemptions and investment subsidies as Li and Resnick (2003) contend.

Conversely, democracies give voice to a larger share of the population, including agents who would lose from FDI if it challenged local firms. Li and Resnick (2003) therefore suggest that the demand for protection from FDI is more likely met in democracies, because losers from FDI have more ways to influence policymakers. Public policy should therefore be less favorable to FDI in democracies.

The argument must however be qualified, because the interests of the losers from FDI must be weighed against those of the winners from FDI. In most countries, the median voter is endowed with more labor than capital. The median voter therefore stands to benefit from capital inflows, according to the Stolper-Samuelson theorem, and should therefore support FDI-friendly policies. By moving decision power towards the median voter and away from an elite typically endowed with more capital than the median voter, democracy should result in more

FDI-friendly policies, as Pandya (2014) argues. In line with her argument, Pandya (2014) observes that democratic countries impose fewer restrictions on FDI.

The third dimension along which democracies differ from autocracies is industrial policy. Li and Resnick (2003) or Pandya (2014) argue that autocratic regimes can support the existence of large monopolistic groups thanks to the political or kinship connections illustrated by Fisman (2001). Although democratic regimes may not eliminate those connections, they likely make them more difficult. Conversely, because democracies give voice to a larger share of the population, they are less likely to accept monopolies, whose benefits of monopolies accrue to a subset of the population, while their costs are borne by the population at large. In addition, by giving a commitment to income redistribution, democracies provide an insurance against the adverse consequences of capital inflows for some groups of the population. They therefore give citizens an incentive to support market liberalization, in line with Grosjean and Senik's (2011) finding. The three arguments imply that democracies should implement more market-friendly policies. This has been documented by Rode and Gwartney (2012), Giuliano et al. (2013), and Bjørnskov and Rode (2014).

More generally, democracies have been found to implement policies that indirectly attract FDI, for instance by fostering education (Gallego, 2010) and openness to trade (Aidt and Gassebner, 2010).

The effect of democracy on risk to property rights

Firms that invest in a foreign country face a risk of expropriation. Although outright seizure of assets is rare, firms can lose part of their assets or revenues because of taxation, regulations on foreign ownership, capital controls, devaluations, theft of intellectual property rights, or more generally because of policy changes that reduce the revenue streams generated by their assets (Jensen, 2003, Li and Resnick, 2003, Henisz, 2004). The attractiveness of democracies or autocracies will therefore depend on the capacity of the two types of regime to protect property rights.

Przeworski and Limongi (1993) recall that early thinkers on the impact of democracy on property rights, such as David Ricardo and Karl Marx, considered that universal suffrage would undermine property rights, because of the incentive for poorer voters to expropriate the rich. Alesina and Rodrik (1994), Persson and Tabellini (1994), and Acemoglu and Robinson (2001)

provide modern variants of the argument in models where democracies redistribute income towards the median voter.

In contrast to those arguments, North (1990) and North and Weingast (1989) argue that democracy guarantees safer property rights, because it implies checks and balances that constrain policy-makers. In a democracy, changing laws requires the agreement of several veto players. As their number increases, the probability of policy changes that may affect property rights decreases, as Tsebelis (1995) or Henisz (2004) point out. Dutt and Mobarak (2016) moreover argue that the variance of policies will be smaller in a democracy, because decision-making power is shared across citizens who can aggregate more information in a manner akin to that of a Condorcet jury.³ By contrast, decision-making power in an autocratic regime is concentrated. In line with those arguments, the empirical evidence, provided for instance by Adserà et al. (2003) or Besley and Ghatak (2010), in general points to a positive association between democracy and the safety of property rights.

2.2 The specific impact of democratic transitions on risk

The previous section contrasts democratic and autocratic regimes on average, but the attractiveness of the two regimes may evolve over time around transitions, because of the evolution of risk. Firstly, property rights are more at risk after democratic transitions. Secondly, transitions themselves are at risk, as they can be reversed.

A first reason why property rights are at risk in the aftermath of a democratic transition is that the transition implies a transfer of power away from the previous ruling elite towards a larger share of the population that may seek redistribution. The notion that democratic transitions are a commitment to redistribution is the basic premise of Acemoglu and Robinson's (2001) theory of democratization. The theory implies that democratic transitions result in a redistribution of income, even when they are the outcome of orderly concessions by the ruling elite. In addition, new democratically elected leaders may respond to the demand for redistribution and to the resentment against the previous regime by seizing the assets of unpopular minorities to secure popular support, as Clague et al. (1996) or Li and Resnick (2003) remark.

³ To save on space, we only focus on the most direct risks to property rights here. Méon and Sekkat (2016) provide a more comprehensive survey of the impact of democracy on political risk.

Moreover, it takes time for a new democracy to establish a functional rule of law. Clague et al. (1996) remark that democracies often appear in anarchic conditions, without the adequate infrastructure to protect property rights. They argue that it takes time to build an effective legal system delineating property rights and backing contracts, either with the State or between private individuals. The system must accumulate jurisprudence, or import and adjust codes and jurisprudence from abroad. New rules must acquire credibility, which means that citizens must revise their expectations to start expecting that those rules are indeed binding, all of which takes time.

In line with those contentions, Clague et al. (1996) observe that various measures of the safety of property rights tend to be poor in young democracies, but improve with the number of consecutive years that a country has been a democracy.

The second reason why property rights are less secure after a democratic transition is that democracy itself is not guaranteed, because the transition can fail and the country return to autocracy. Acemoglu and Robinson's (2001) model of political transitions describes transitions as a way for the richer elite to commit to increased redistribution in an unequal society. It implies that the elite may subsequently be tempted to mount a coup to restore an autocratic regime and reduce redistribution, in particular when a shock like a recession reduces income. Eventually, as democracy matures, it reduces income inequality through redistribution, and increases the cost of mounting a coup. Democracy thus consolidates, but consolidation takes time. In the meantime, foreign investors face the additional risk of a regime reversal.⁴

Persson and Tabellini (2009) develop a model where democracy becomes more robust to reversals over time, because citizens become increasingly committed to defend democracy. The model assumes that the citizens receive a warm glow from fighting for democracy that increases with the stock of "democratic capital", which they accumulate while their country is a democracy. Accordingly, older democracies are more resilient, because their citizens have accumulated more democratic capital, and are therefore more willing to fight to defend them. When they take their model to the data, Persson and Tabellini (2009) indeed observe that countries that have been democracies for a longer period of time tend to continue being democratic. Svobik (2015) also shows, using a sample of 145 countries observed from the

⁴ A corollary of the model is that redistribution is volatile during the transition period, resulting in additional uncertainty on property rights, because the government of the democratic regime can be forced to reduce transfers to give in to the pressure of the richer elite and avoid a coup.

onset of the French Revolution to the present, that the risk of coups decreases over time after a democratic transition.

A related argument, going back to Olson (1993), is that a democracy is not viable if it lacks the institutional apparatus that is necessary for peaceful and orderly transfers of power. Olson (1993) remarks that for such transfers to exist, the system must ensure that the opposition has the right to free speech, and that institutions actually bind democratic leaders. This implies the setup of an independent court system and the respect for the law, that incidently secure property rights. Countries that have just democratized may or may not be able to build such an infrastructure, but only democracies that can provide that infrastructure can last. In addition, building that infrastructure takes time, which implies that in the aftermath of a democratic transition, both democracy and property rights are fragile, as argued by Clague et al. (1996). Actually, democracy and property rights consolidate over time or disappear. Transition periods therefore entail a specific risk.

To sum up, the total effect of democratic transitions on FDI consists of three components. The first is the intrinsic effect on foreign investors of becoming a democracy. The second comes from the fact that recent democratic transitions may be reversed. The third comes from the impact of the process of democratic transitions on property rights. To isolate the intrinsic impact of democratic transitions on FDI, one must therefore control both for the risk of autocratic reversals and for the evolution of the risk to property rights that democratic transitions entail. The next section describes how we do it.

3. Method and data

3.1 Econometric strategy

To determine whether and how fast FDI inflows are affected by democratic transitions, we apply to foreign direct investment the event study method used by Rodrik and Wacziarg (2005), Papaioannou and Siourounis (2008), Méon et al. (2009), or Acemoglu et al. (forthcoming) to study the impact of democratic transitions on growth or productivity. The method uses a panel of countries, and defines a series of dummy variables capturing episodes of democratic transition. It is summarized by the following equation:

$$FDI_{i,t} = \rho FDI_{i,t-1} + \alpha D_{i,t} + \beta Risk_{i,t} + \gamma A_{i,t} + \Gamma X'_{i,t} + \phi_t + \eta_i + \varepsilon_{i,t} \quad (1)$$

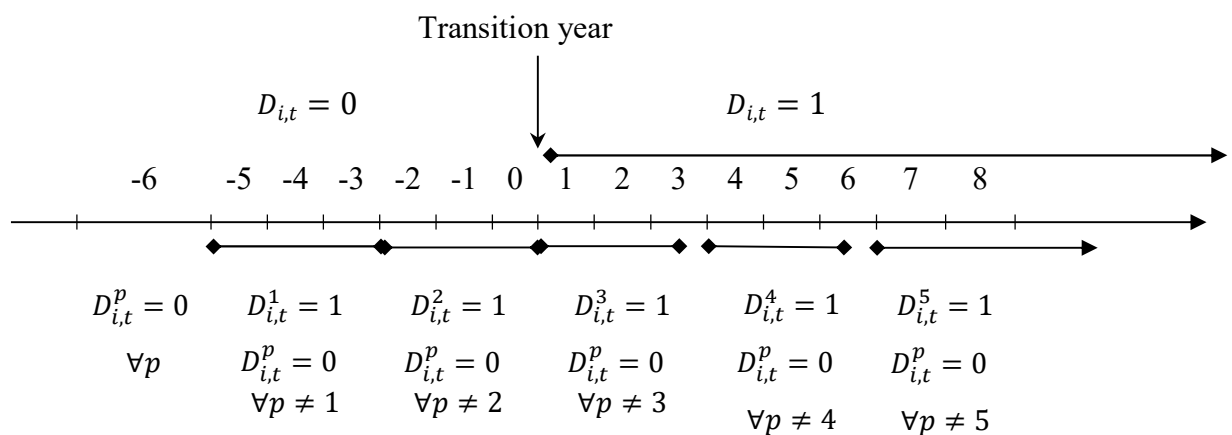
where:

- $\frac{FDI_{i,t}}{GDP_{i,t}}$ stands for FDI inflows over GDP (in percent) in Country i and Year t ;
- $D_{i,t}$ is a dummy variable capturing democratic transitions;
- $Risk_{i,t}$ is an index of political risk;
- $A_{i,t}$ is a dummy for transition to more autocracy;
- $X'_{i,t}$ is a set of control variables;
- ϕ_t is a year fixed effect;
- η_i is a country fixed effect;
- $\varepsilon_{i,t}$ is the error term;
- $\alpha, \beta, \gamma,$ and ρ are coefficients;
- Γ is a vector of coefficients.

The variable of interest is $D_{i,t}$, which captures the timing of democratic transitions. It is set to one in the year of the democratic transition in country i and in all the following years, as long as the transition has not been reversed. The dummy is set back to zero if the country goes through an autocratic reversal. Figure 1 summarizes how $D_{i,t}$ is constructed.

Variable $A_{i,t}$ is constructed in the same way as $D_{i,t}$, except that it is defined around autocratic transitions.

Figure 1: Definition of democratic transition dummies



Equation 1, allows comparing FDI inflows before and after democratic transitions, but imposes the effect to be the same during all the year that follow the transition. To relax this constraint, we estimate Equation 2, where $D_{i,t}$ is replaced by a series of dummies $D_{i,t}^p$ ($p = 1, 2, 3, 4, 5$):

$$FDI_{i,t} = \rho FDI_{i,t-1} + \sum_{p=1}^5 \alpha_p D_{i,t}^p + \beta A_{i,t} + \gamma Risk_{i,t} + \Gamma X'_{i,t} + \phi_t + \eta_i + \varepsilon_{i,t} \quad (2)$$

The two dummies $D_{i,t}^1$ and $D_{i,t}^2$, capture the pre-transition and transition periods while the three dummies $D_{i,t}^3$, $D_{i,t}^4$, and $D_{i,t}^5$, capture post-transition periods. $D_{i,t}^1$ equals one from 5 years to 3 years before the democratic transition and zero otherwise. $D_{i,t}^2$ equals one from 2 years before to the democratic transition year and zero otherwise. $D_{i,t}^3$ equals one from one year to three years after the democratic transition and zero otherwise. $D_{i,t}^4$ equals one from four years to six years after the democratic transition and zero otherwise. $D_{i,t}^5$ equals one from seven years after the democratic transition onward and zero otherwise. In case of reversal, the dummies return to zero for the reversal year and the subsequent years.⁵ Figure 1 also describes how those five dummies are defined. This way of coding transitions allows the impact of transitions to change over time.

Equations 1 and 2 constitute a difference-in-difference model or event-study model, where countries that have undergone a transition are the treated group, while non-reforming countries serve as the control group. Thanks to the inclusion of country and year-fixed effects, coefficients α_p (α) measure the impact of democratic transitions on FDI flows.

Both equations are estimated using ordinary least squares (OLS). To avoid the consequence of serial correlation raised by Bertrand et al. (2004), we allow for autocorrelation in standard errors, and report robust clustered standard errors with clusters defined at the country level.

For the method to lead to unbiased estimates, transitions should be exogenous. That assumption is supported by the fact that revolutions are to a large extent unpredictable, as

⁵ Except if a new democratic transition occurs. In that case the coding restarts from $D_{i,t}^1$ and $A_{i,t}$ equals 0 from the year of democratic transitions onwards.

Kuran (1989, 1991) argues. Moreover, Bueno de Mesquita (2010) provides a model of regime changes that produces multiple equilibria, and Gorodnichenko and Roland (2015) relate the probability of democratic transition to a country's culture, which varies little over time. As a result, transitions can only be loosely related to other time-variant variables. In line with this contention, Treisman (2015) shows that while structural factors matter in the medium run (10-20 years), they provide little information on the timing of transitions. Treisman (2017) even attributes two thirds of democratic transitions to mistakes, which are by definition difficult to predict. The possibility of a reverse causality therefore seems weak.

We test the assumption that countries that undergo a transition do not differ from the others before the transition by checking that the coefficients of the dummy variable $D_{i,t}^1$ is statistically insignificant. Finding that the coefficient of that variable is insignificant signals that the countries that underwent a transition followed the same trend as the rest of the sample before the transition. In any case, we will address endogeneity in Section 6.

Both models control for an index of political risk, in line with Li and Resnick (2003), so as to control for the evolution of the risk to property rights that may hide the effect of democracy.

To gauge the additional risk of autocratic reversal, we estimate both models using two sets of democratic transitions, throughout the paper. Specifically, we distinguish the subset of consolidated democratic transitions from the unrestricted set of democratic transitions. Consolidated democratic transitions are defined as democratic transitions that were not reversed within five years, in line with Papaioannou and Siourounis (2008) who impose a five-year stability condition on transitions. By contrast, Acemoglu et al. (forthcoming) impose no such condition. Comparing the results obtained with the unrestricted set of democratic transitions to those obtained with the subset of consolidated democratic transitions allows distinguishing the impact of the risk of reversal from the rest of the effect of democratic transitions.

3.2 Data

Foreign direct investment

We drew the data on FDI inflows from the United Nations Commission for Trade and Development (UNCTAD) database. It provides detailed annual data on FDI inflows over GDP from 1970 to 2014.

Democratic transitions

In order to identify episodes of democratic transitions, we started from the dataset of democratic transitions from Acemoglu et al. (forthcoming), and updated it till 2014 using the protocol they used. Specifically, we made a first selection of transitions corresponding to an improvement in the Freedom House index (from not free to partially free, from partially free to free or from not free to free) or to an increase in the Polity IV index to a positive value. We then used bibliographic sources to make sure that changes in the two indexes indeed signaled a democratic transition. We set the democratic transition year to the first year when free and fair elections were held or constitutional changes towards democracy occurred.

ICRG Political risk

To measure political risk, we use the International Country Risk Guide index published by the Political Risk Service Group since 1984. That index is the sum of twelve risk components. One of them is democratic accountability, which is close to what we want to capture with the dummy variables coding democratic transitions. We therefore computed a “democratic accountability-free” ICRG index as the sum of the eleven other basic components, to which we refer as the ICRG₁₁ index. In our sample, the ICRG₁₁ index ranges from 8.58 to 77.04 with a mean of 53.64.

When merging the various data sources, we obtain an unbalanced panel featuring 115 developing countries from 1970 to 2014, totaling 4,818 observations, an average of 41.9 observations per country. The dataset features 95 democratic transitions, out of which 67 are consolidated, in that they were not reversed within five years (see Appendix 2). We lose observations when controlling for the ICRG₁₁ index, as the index is only available from 1985, but the dataset still contains 2,476 observations featuring 85 countries and 29.1 observations per country on average. This dataset features 60 democratic transitions out of which 50 consolidated.

4. Baseline Results

In this section, we first report our baseline results, then discuss country cases that exemplify those results and provide a series of robustness checks.

4.1 Baseline econometric results

We start by estimating Equations 1 and 2 without imposing restrictions on democratic transitions, then restrict democratic transitions to consolidated transitions. In all tables odd-numbered columns report the results obtained with all transitions, while even-numbered columns report the results obtained with consolidated transitions only. In all tables, the first two columns compare the pre- and post-transition periods by estimating Equation 1 and therefore contrast the post- and pre-transition periods with dummy variable $D_{i,t}$, while the last two columns are based on Equation 2 and distinguish five periods around the transition with the five $D_{i,t}^p$ dummy variables.

Table 1 reports the results of the estimations of Equation 1 when political risk is not controlled for. In all the regressions of that table, the coefficient of lagged FDI is significantly positive at the one-percent level and lower than one. The implied evolution of the FDI to GDP ratio therefore displays persistence but is not explosive.

*** INSERT TABLE 1 HERE ***

In Column 1.1, where we impose no restriction on the definition of democratic transitions, the coefficient of transition dummy $D_{i,t}$ is insignificant at usual levels of confidence. Democratic transitions therefore do not seem to correlate with FDI in general. However, when we restrict democratic transitions to consolidated transitions in Column 1.2, the coefficient of $D_{i,t}$ becomes positive and significant at the five-percent level. On average, countries that have consolidated a democratic transition receive more FDI. The estimated effect is that consolidated transitions add 0.585 percentage points to the ratio of FDI to GDP each year. Because the specification is dynamic, in that FDI in t is a function of FDI in $t-1$, the ratio of FDI to GDP ten years after a democratic transition should be 1.06 percentage points higher than if the country had not democratized.⁶

Columns 1.3 and 1.4 decompose the transition period to allow the effect of democratic transitions on FDI inflows to vary over time. As before, we impose no restriction on the

⁶ The effect after k year equals $\hat{\alpha}/(1 - \sum_{j=1}^k \hat{\rho}_j)$. $\hat{\alpha}$ is the estimated coefficient of the democracy dummy in Model 1 and $\hat{\rho}_j$ is the coefficient when regressing the current value of FDI on lagged values up to k lags ($\hat{\rho}_j$ being the coefficient associated to the j^{th} lag of FDI/GDP).

definition of democratic transitions in Column 1.3, and consider only consolidated transitions in Column 1.4. An important finding is that in both regressions, the coefficient of the dummy variable that captures the pre-transition period, $D_{i,t}^1$, is statistically insignificant at accepted levels. This suggests that democratic transitions have no anticipation effect, which in turn lends credence to a causal interpretation of the other coefficients.

When turning to post-transition dummies, we observe no significant effect of democratic transitions in Column 1.3. That regression therefore confirms that democratic transitions in general are not associated with higher levels of FDI. However, when we restrict democratic transitions to consolidated transitions, in Column 1.4, we find that the coefficient of $D_{i,t}^5$ is positive and significant at the ten-percent level. Accordingly, consolidated democratic transitions seem to increase FDI after six years. The magnitude of the effect then amounts to 0.790 points of the FDI to GDP ratio per year, which is comparable to the effect implied by Column 1.2.

*** INSERT TABLE 2 HERE ***

The finding that consolidated transitions affect FDI only after six years may be driven by the fact that transitions imply an increased risk. We therefore control for the ICRG₁₁ index in Table 2. To provide a benchmark against which to weigh the other regressions, Columns 2.1, 2.2, 2.5, and 2.6 report the same specifications as Table 1, but restrict the period of study to period over which the ICRG₁₁ index is available, which also allows a first robustness check. Columns 2.3, 2.4, 2.7 and 2.8 report the same specifications when controlling for the ICRG₁₁ index.

In all the regressions of table 2, the coefficient of lagged FDI is significantly positive at the one-percent level and lower than one. The regressions therefore also imply that the FDI to GDP ratio is persistent but not explosive.

Columns 2.1, 2.2, 3.5, and 2.6 that simply replicate the results of Table 1 on a different period, confirm previous results. The main difference is that the coefficient of the dummy capturing autocratic reversals is now statistically insignificant at standard levels of significance. Again, we can find an effect of democratic transitions only when they are restricted to consolidated transitions. In that case, the coefficient of the dummy variable coding consolidated

democratic transitions, $D_{i,t}$ is significant at the five-percent level in Column 2.2. The coefficient of $D_{i,t}^5$ is positive and significant at the ten-percent level in Column 2.6 implying that the effect of consolidated democratic transitions materializes after six years.

When we control for the ICRG₁₁ index in Columns 2.3, 2.4, 2.7 and 2.8, the adjusted R-squared increases, and ICRG₁₁ index exhibits a positive coefficient that is significant at the ten-percent level, confirming that lower risk increases FDI, in line with the literature (see e.g. Alfaro et al., 2008).

The results of Columns 2.3 and 2.7 confirm that transitions in general do not affect FDI, even when controlling for the evolution of political risk, as all the dummy variables capturing transitions are statistically insignificant in those regressions. The results for consolidated transitions, reported in Columns 2.4 and 2.8 however tell a different story. In Column 2.4, dummy $D_{i,t}$ is significant at the five-percent level, like in Column 1.2 in Table 1 and in Column 2.2 in Table 2. The coefficients of $D_{i,t}$ in Column 2.4 also is moreover of the same magnitude as in Column 2.4. Controlling for political risk therefore does not alter the magnitude of the coefficient of $D_{i,t}$. This suggests that the impact of consolidated democratic transitions goes beyond their impact on risk. In other words, foreign investors are intrinsically attracted by countries that have consolidated their transition to democracy.

This result is confirmed by Column 2.8, where the impact of democratic transitions is allowed to vary over time. Again, we observe that the sign of $D_{i,t}^1$ is statistically insignificant, suggesting that transitions do not have anticipation effects. The striking result of Table 2 is that while $D_{i,t}^5$ still bears a positive coefficient that is significant at the ten-percent level, like in Column 1.4 of Table 1, it is no longer the only one. $D_{i,t}^2$, $D_{i,t}^3$, and $D_{i,t}^4$ now also bear a positive sign that is significant at the ten-percent level. This implies that higher political risk in the wake of democratic transitions hid the intrinsic effect of consolidated democratic transitions on FDI. When political risk is controlled for, the positive impact of those transitions can be observed immediately, specifically at the same time as the transition itself, as the positive coefficient of $D_{i,t}^2$ signals, and remains visible during the following fifteen years.

The upshot of this section is the following: Firstly, democratic transitions in general have no effect on FDI. Secondly, consolidated democratic transitions do. Thirdly, the effect on FDI of consolidated democratic transitions is still observable when political risk is directly controlled for, and appears faster. This suggests that political risk and the risk that democratic

transitions may fail hide the intrinsic appeal to foreign investors of democratic transitions. Moreover, the impact of democratic transitions does not boil down to a reduction in political risk.

4.2 Illustrative examples

This section discusses three country-cases of consolidated democratic transitions in three different continents exemplifying both the positive impact of consolidated transitions on FDI and the role of political risk in that relation: Niger in 1999, Mongolia in 1993, and Chile in 1990. For each transition, we report two series: the first one is the residuals of a regression of the FDI to GDP ratio on year fixed effects, the second one is the residuals of a regression of the ratio on year fixed effects *and* the ICRG₁₁ measure of political risk (Figure 2 to 4). Specifically, the first series is constructed as follows. First, we remove year fixed effects from the FDI to GDP ratio: for each year, we subtract from each country's ratio the world average of FDI to GDP ratio in that year. Second, we focus on countries having experienced a transition, and compute the average of the transformed FDI ratio five, four, etc. years before the transition, at the transition year, and one, two, etc. years after the transition. Stopping at the tenth year after the transition, we obtain 15 numbers reflecting the average change in the transformed FDI ratio around the year of a democratic transition. Finally, for the sake of clarity we subtract from each of the 15 numbers the one corresponding to the transition year, to obtain an index normalized to zero in the transition year.

President Baré had been the president of Niger since his January 1996 coup, when he was assassinated in a military coup on 9 April 1999.⁷ The military junta announced a nine-month transition to restore democracy, and indeed stepped down at the end of the transition period after drafting a new constitution. A fair election appointed Mamadou Tandja president. President Tandja could run the country thanks to a stable coalition, and was eventually reelected in 2004, thereby becoming the first president in Niger to be reelected without being deposed by a military coup. Despite a food crisis and a gradual personalization of power, epitomized by a motion of no confidence passed against Prime minister Hama Amadou in May 2007, the country gave little sign of authoritarian reversal until 2009, when Tandja modified the constitution thanks to a referendum declared illegal by the Constitutional Court. Tensions

⁷ On the history of Niger over the "Fifth Republic", one may refer to Baudais and Chauzal (2010).

accumulated during the period, resulting in a steady deterioration in the ICRG₁₁ index from 60.92 to 54.04 between 2000 and 2009. Yet, Tandja was not deposed until 18 February 2010, and the 1999 democratic transition was not reversed for ten years. It therefore qualifies as a consolidated transition in our sample.

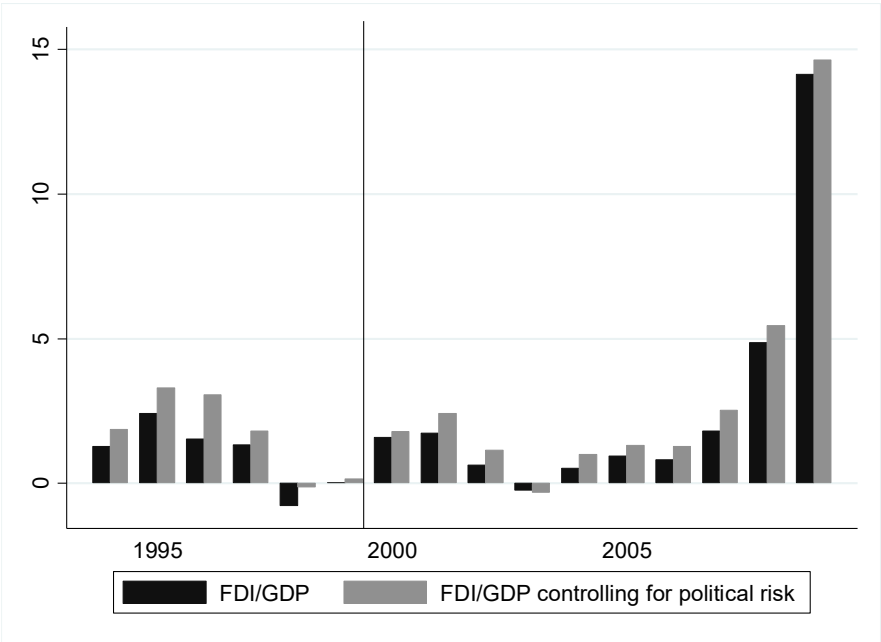


Figure 2: Evolution of FDI around the 1999 democratic transition in Niger.

Figure 2 describes the evolution of FDI flows around the 1999 transition in Niger. During the five years preceding the transition, the FDI to GDP ratio was on average slightly higher than in 1999. In the first years following the 1999 democratic transition, the ratio increased slightly before falling below its pre-transition value. However, after five years, and the 2004 presidential election, the ratio started increasing steadily to reach a maximum after ten years. The pattern is slightly more visible when controlling for political risk. The increase in the FDI/GDP ratio then amounts to 1.15 percentage points after three years, 1.31 after six years, and 5.45 percentage points after nine years. This confirms that although political risk reduced the positive impact of the transition, it was not large enough to prevent FDI from flowing in the country after the transition consolidated. The pattern of FDI flows to Niger therefore illustrates the general pattern appearing in our baseline regressions.

Mongolia was an unlikely candidate for a consolidated democratic transition, given its low income, geographic distance from other democracies, position between China and Russia, and Soviet background. Yet, it has remained a democracy since its unexpected and peaceful transition in 1993, following a process whereby the communist party, the Mongolian People’s Revolutionary Party (MPRP), gradually accepted free and fair elections.⁸ In December 1989 an oppositional movement started organizing demonstrations demanding democratic reforms. The demonstrations attracted up to 100,000 participants during a meeting of the Politburo in March 1990. The Politburo reacted by stepping down and conceding the end of the single-party system. As a result, new parties were legalized in May 1990, and free parliamentary elections were organized in July. They were won by the MPRP, that still had a privileged access to the media. Yet, the parliament adopted a new constitution on 12 February 1992. In the Parliamentary election of July 1992, the MPRP gained 90 percent of the seats. The country was therefore still a de facto one-party state. It nonetheless gradually liberalized the economy and, in 1993, organized the first free presidential election.

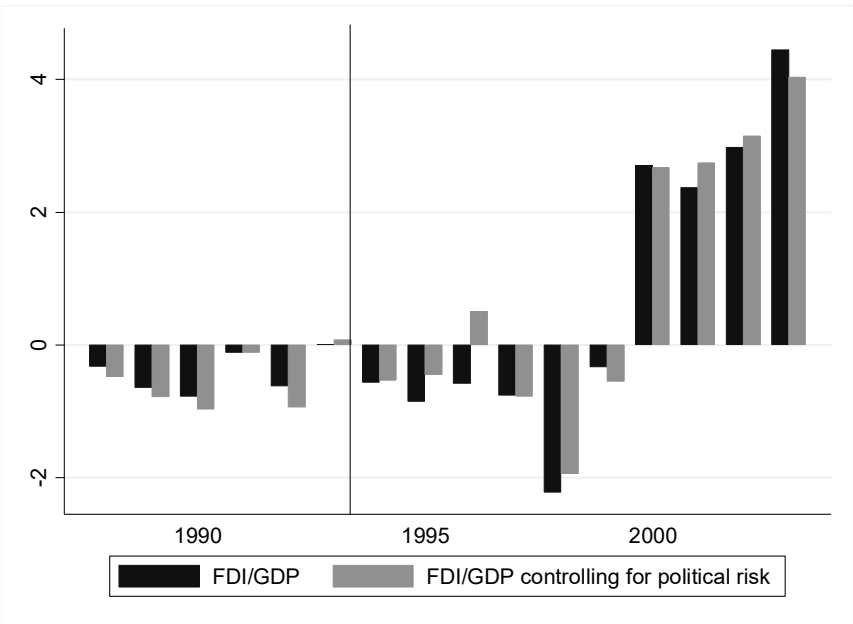


Figure 3: Evolution of FDI around the 1993 democratic transition in Mongolia

⁸ Pomfret (2000) and Fritz (2008) give detailed accounts of the transition in Mongolia.

The election resulted in the election of P. Orchibat, who was supported by the opposition, which is why 1993 is the transition year. Later parliamentary elections were won by the opposition in 1996, the MPRP in 2000, and led to a coalition government in 2004, showing that the peaceful changeover of power had become the norm in the country. Over the post-transition period, the country experienced a steady improvement of the ICRG11 from 60 in 1993 to 72.83 in 2003, before reaching a plateau due to rising corruption, and government instability driven by struggles between and within parties (Fritz, 2008).

Figure 3 describes the evolution of Mongolia's FDI ratio net of period fixed effects and net of both period fixed effects and political risk. Neither series exhibits a pre-transition trend. The FDI ratio net of period fixed effects fluctuates between -0.77 and -0.12 percentage points, while the FDI ratio net of period fixed effects and political risk fluctuates between -0.97 and -0.12 from 1988 to 1992. The early years after the transition display no major change in the FDI ratio. If anything, Figure 2 shows a drop in FDI in 1998. However, the FDI ratio increases sharply in 2000, after the second peaceful change of majority in parliament. We may interpret this finding as suggesting that foreign investors waited until the transition consolidated to invest in the country, which is suggestive, as the country had adopted FDI-friendly laws as soon as 1990. In line with our baseline findings, the FDI ratio corrected for both political risk and year fixed effects is in general larger than the FDI ratio corrected for year fixed effects only. It even exceeded its pre-transition level as soon as 1996. The Mongolian case therefore also fits our baseline findings.

The 1990 democratic transition in Chile was indisputably unexpected. It started when president Augusto Pinochet, who had been in power since the 1973 coup, called for a plebiscite on October 5, 1989 to extend his mandate. To his and most observers' surprise, he lost by a margin of 55 to 43 percent (Angell and Pollack, 1990, Boas, 2015). As there was no support in the military for a violent repression, the lost plebiscite was followed by open elections resulting in the appointment of the first civilian president since 1973, Patricio Aylwin, and a coalition supporting him in both chambers of congress. Patricio Aylwin was inaugurated in March 1990, which is therefore the transition year (Gonzalez, 2008, p.181). Despite the military remaining influential, Aylwin could complete his mandate, and was replaced by Christian Democrat Eduardo Frei Ruiz-Tagle in 1994 following a democratic election in December 1993. Chile's transition has to this day not been reversed, and therefore qualifies as a consolidated transition.

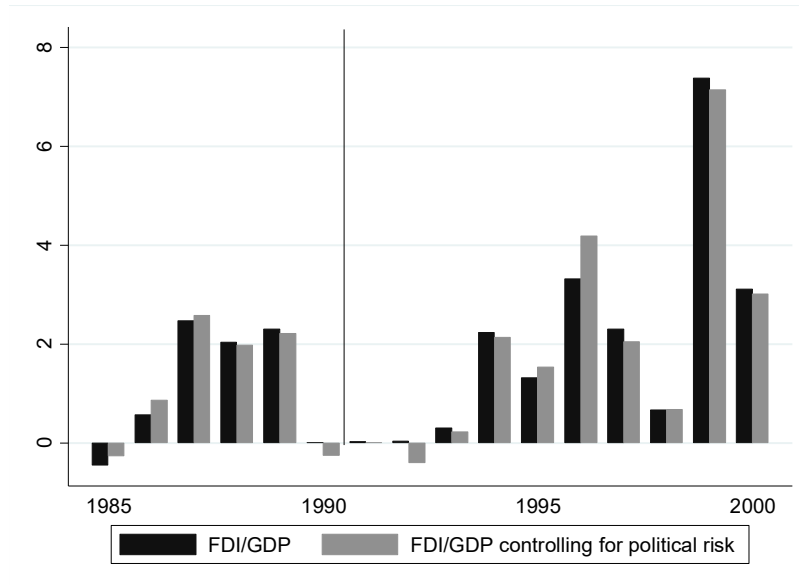


Figure 4: Evolution of FDI around the 1990 democratic transition in Chile

Figure 4 describes the evolution of Chile's FDI ratio net of year fixed effects and net of both period fixed effects and political risk. Both series followed no obvious trend before the transition. FDI flows to the country dropped in the transition year and the four years thereafter. However, the ratio came back to its pre-transition level in 1994. One rationale for that evolution is that Chile had implemented FDI-friendly policies under the Pinochet regime and that those policies could have been put at risk by the transition until it consolidated (Ffrench Davis, 2002, p.17). By the same token, one may explain the trough in FDI observed in 1998. At that time, attempts to reform the constitution and the Supreme Court fueled political antagonisms (Gonzalez, 2008, pp.202-209), resulting a deterioration of the country's ICRG₁₁ score. FDI peaked again in 1999, as soon as those tensions had been overcome, allowing the country to take advantage of the global FDI wave of the late nineties. Again, Chile's case illustrates that FDI inflows increased a few years after the democratic transition, in line with our main finding.

4.2. Robustness checks

Beside political risk, we have so far only controlled for time-invariant country characteristics. The coefficient of the transition dummy variables therefore captures the total effect of transitions on FDI. However, transitions may indirectly affect FDI by impacting other variables that affect FDI. The literature has in particular documented the impact of transitions on growth (Rodrik and Wacziarg, 2005, Papaioannou and Siourounis, 2008, Acemoglu et al.,

2017) and human capital (Gallego, 2010, or Eterovic and Sweet, 2014, for a focus on Latin America). To test the extent to which those mechanisms interfere with the effect of democratic transitions, we controlled for GDP per capita and for secondary schooling enrollment. Both variables were retrieved from the World Development Indicators.

The main findings were unaffected. Specifically, regardless of the set of control variable we could find no effect of democratic transitions when all transitions are pooled together, but observed consolidated transitions had a positive and statistically significant effect on FDI. Again, the effect of transitions appeared earlier and was larger when political risk was controlled for than when it was not.

FDI flows are volatile. A single large investment can have a sensible effect on a small country's FDI to GDP ratio. To test how sensible our baseline results are to extreme cases, we defined outliers as observations not belonging to the interval defined by $[\mu - 3\sigma; \mu + 3\sigma]$, where μ is the mean value of the FDI to GDP ratio and σ its standard error in the sample. We then estimated Equations 1 and 2 again. The main results were unaffected.⁹

Following Papaioannou and Siourounis (2008), Equation 2 defines five $D_{i,t}^p$ dummy variables around democratic transitions. Each of them is equal to one for three years. Yet, one may argue that by pooling all years beyond the sixth year after a transition, $D_{i,t}^5$ pools the medium term and the long term of the transition. By the same token, we pool the years that follow the transition in bunches of three years, whereas the effect of democratic transitions over individual years may be quite different in the short run. To make sure that our results were not driven by the way in which we coded transitions, we considered two alternative specifications, imposing less structure on the way the estimated relationship codes respectively the long run and the short run of transition periods. First, we split the dummy variable coding the long run, $D_{i,t}^5$, into six three-year dummies.¹⁰ We still observed a positive effect in the long run of

⁹ The results are reported in Table A6 in the appendix.

In a related robustness check, we dropped from the sample the countries that appeared after the break-up of the USSR. Our main results were robust to dropping those countries.

¹⁰ The results are reported in Table A7 in the appendix.

consolidated democratic transitions on FDI. It materialized more precisely from the twelfth year after the transition onwards.

Second, we split the dummy variables coding the short and medium run after the transition, D_{it}^3 and D_{it}^4 , into single-year dummy variables.¹¹ Again, we could find a positive effect of consolidated democratic transitions on FDI, but not of democratic transitions in general. The effect appears in the seventh year after the transition. When we controlled for political risk, we could observe the effect earlier, specifically in the second year after the transition.

The ICRG₁₁ index pools eleven types of risk, each of which may evolve differently around democratic transitions and affect FDI in a different way. To make sure that the way they are aggregated did not drive our results, we separately controlled for each of the eleven subcomponents of the index.¹² When we did that, we observed that the law and order, government stability, and ethnic tensions components of the ICRG₁₁ index were those that were the most robustly associated with FDI inflows, suggesting that they are the dimensions of political risk that matter the most to foreign investors. However, the observed impact of democratic transitions was unchanged. Our results were therefore robust to the subcomponent of the ICRG₁₁ index that we controlled for.

5. Tackling endogeneity

We have argued that the event-study method that we use measures the causal effect of democratic transitions, because the timing of the transition is likely exogenous. However, we cannot completely rule out the possibility of endogeneity bias, either because FDI affects the propensity of a country to democratize, like Aidt and Albornoz (2011) argue, or because an omitted variable drives both FDI and democratic transitions. We therefore directly address that possibility in this section, successively by using techniques generating counterfactuals based on observables, specifically local projections and propensity score matching, and instrumental variable regressions.

¹¹ The results are reported in Table A8 in the appendix.

¹² The results are reported in Tables A9a to A10b in the appendix.

5.1. Local projections

Local projections aim at simulating the FDI that a country would have obtained if it had not democratized. We use the method described in Jordà (2005) and used by Acemoglu et al. (forthcoming) to assess the impact of democratic transitions on growth. The estimator proceeds in two steps. First, we estimate the counterfactual path of FDI inflows in a country that democratized had it not democratized. To do so, we regress the value of FDI inflows over GDP on a set of year fixed effects and on $FDI_{i,t-1}, FDI_{i,t-2}, FDI_{i,t-3}, FDI_{i,t-4}$ for each year from 5 years before the transition to 20 years after it. The use of four lags is in line with previous literature (see e.g. Acemoglu et al., forthcoming). Formally we estimate the coefficients of the following equation for countries that did not democratize (for which $D_{c,t} = 0$ and $D_{c,t-1} = 0$) and for $k = -5, -4, \dots, +19, +20$ (where $X'_{i,t}$ is the measure of political risk at time t to account for the legacy of political risk k years ago in the construction of the counterfactual).

$$FDI_{i,t+k} = \alpha + \beta_1 FDI_{i,t-1} + \beta_2 FDI_{i,t-2} + \beta_3 FDI_{i,t-3} + \beta_4 FDI_{i,t-4} + \phi_{t+k} + \Gamma X'_{i,t} + \varepsilon_{i,t} \quad (3)$$

In the second step, we estimate the counterfactual path of FDI for countries that democratized, using the set of estimators $(\alpha, \beta_1, \beta_2, \beta_3, \beta_4, \phi_t, \Gamma)$ from the first step. Such estimates are pure counterfactuals, as they represent the level of FDI a country should have received if it had not democratized.

Teulings and Zubanov (2014) remark that such an estimator is only affected by a downward bias. Consequently, it provides a lower bound of the effect of democratic transitions on FDI inflows. Finding an effect of democratic transitions with that estimator would therefore be a strong evidence that they affect FDI flows.

*** INSERT TABLE 3 HERE ***

The estimator of the effect of democratic transitions on FDI is the difference between the level of FDI observed at $t + k$ and the value of the counterfactual. Table 3 provides the

means of the estimators over time using four different specifications. In turn, we compute the estimator considering all democratic transitions and only consolidated democratic transitions. For these two specifications, we control for political risk at the time of the projection or not. A consolidated democratic transition provides an advantage mostly fifteen years after a democratic transition onwards. On average, countries receive 1.36 percentage points of GDP more FDI per year from sixteen to twenty years after a consolidated democratic transition compared to what they would have got without a consolidated democratic transition. The whole set of democratic transitions also attracts more FDI in the long run (0.8 percentage points of GDP).¹³ When controlling for political risk, consolidated democratic transitions attract more FDI earlier on (from the sixth to the tenth year after the democratic transition and from the sixteenth to the twentieth after the democratic transition). The magnitude of the effect is in line with baseline results. The whole set of democratic transitions also attract more FDI following a similar timing. Such results also point to the importance of political risk for the attractiveness of new democratic transitions and confirm baseline results.

5.2. Propensity Score Matching

Compared to local projections, propensity score matching does not model future FDI inflows but the propensity of a country to democratize according to time fixed effects and the lagged values of FDI. We follow the technique described in Angrist and Kuersteiner (2011) and Angrist, Jordà and Kuersteiner (2013), and used by Acemoglu et al. (forthcoming).

First, we estimate the propensity to democratize in t for all countries that did not democratize in $t-1$, i.e. with $D_{c,t-1} = 0$. To do so, we run a probit model of the probability to democratize and compute its fitted values for each observation. Formally the propensity score is the following (where $X'_{i,t}$ is the measure of political risk to control for the risk generated at the time of the matched observation):

¹³ The difference between consolidated and the whole set of democratic transitions is not statistically significant but may nevertheless explain the difference in significance in baseline results.

$$P_{c,t} = \alpha + \beta_1 FDI_{i,t-1} + \beta_2 FDI_{i,t-2} + \beta_3 FDI_{i,t-3} + \beta_4 FDI_{i,t-4} + \Gamma X'_{i,t} + \phi_t + \varepsilon_{i,t} \quad (4)$$

In the second step, we match countries that democratized with countries with the same ex ante propensity to democratize but that did not democratize. Specifically, we match each country democratizing in year t with the five observations not democratizing in year t with the five closest scores, which strikes a balance between having enough observations to compare the democratic transitions and picking dissimilar observations in the comparison group. Figures in Appendix A.4 show how close the distributions of the treated and of the comparison groups are before and after matching. The two samples are now very comparable, and each treated unit is compared to a group of similar untreated units. For each matched observation we compare the future FDI inflows of treated countries still under democratic rule with those of the comparison group. To compare $FDI_{i,t+k}$, we add one condition for both treated and non-treated values: they should not experience any autocratic reversal ($A_{i,t+k} = 0$). At $t+k$ we compare countries that democratized in t and that did not reverse to autocracy at $t+k$ to countries that did not democratize at t and did not reverse to autocracy at $t+k$. Figures 5 to 8 introduce the results plotting the difference in FDI between a country that democratized and the average of the comparison group. The four graphs consider in turn all democratic transitions and consolidated democratic transitions, and controlling for risk or not. Dotted lines represent the 90 % confidence interval.

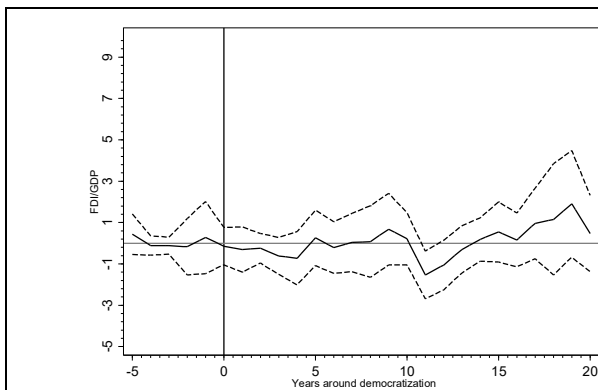


Figure 5: Evolution of FDI/GDP after Matching (All democratic transitions)

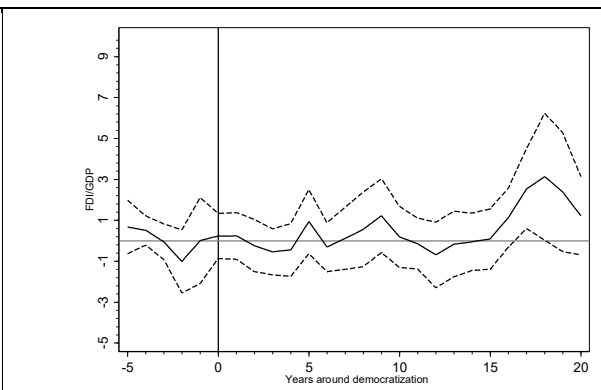
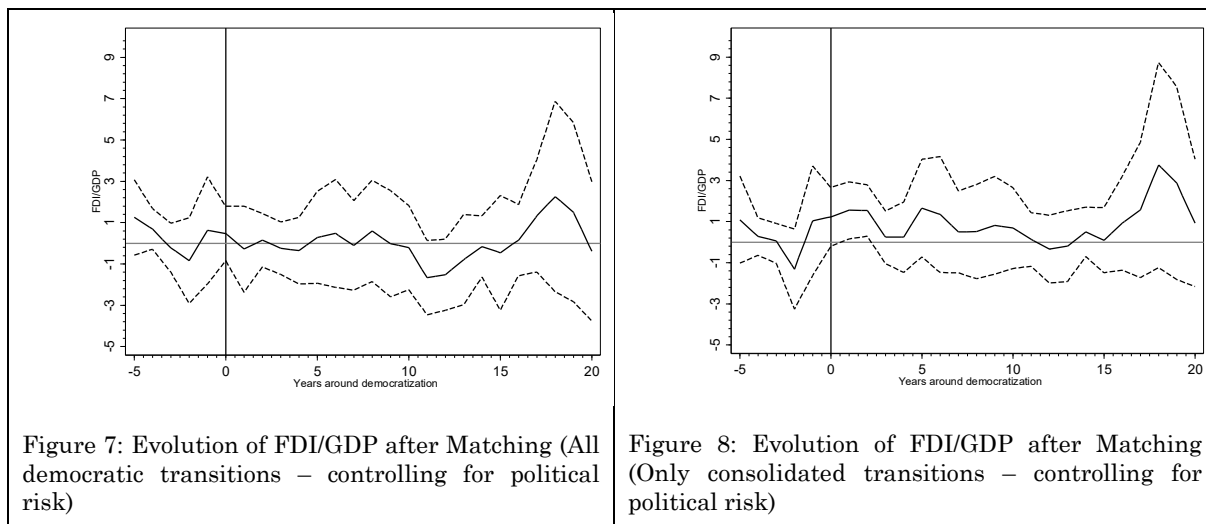


Figure 6: Evolution of FDI/GDP after Matching (Only consolidated transitions)



The four specifications match baseline results. No effect is visible when considering the whole set of democratic transitions, except a negative one twelve years after the transition (Figure 5). No effect appears either when considering the whole set of democratic transitions and controlling for political risk (Figure 7). On the contrary, when we consider consolidated transitions, we observe a positive effect. This effect appears after fifteen years when not controlling for political risk (Figure 6) and exceeds three percentage points of GDP. When controlling for political risk the effect appears immediately after the transitions (from the first to the third year after the transition) and equals 1.5 to 2 GDP percentage points.

Both semi-parametric analyses aimed at assessing the average treatment effect on the treated. The selection on pre-transitions observables also grants the right to interpret the effect as a causal one. Differences between consolidated and the whole set of democratic transitions still hold. Furthermore, the timing of the effect is consistent with previous estimates.¹⁴

5.3. IV estimates

To further check the robustness of our findings with respect to endogeneity, we use an instrumental variable approach. The instruments are composed of two variables constructed as

¹⁴ Slight discrepancies with baseline results might be explained as the lagged value of FDI/GDP is included in baseline results and is not formally controlled for in Propensity score matching estimates and local projections.

follows. The first instrument draws on Acemoglu et al. (forthcoming) and is based on the idea that democratic transitions occur in regional waves (Huntington, 1993). The instrument is the average of transitions dummy variables in a given region excluding the country of observation. While Acemoglu et al. (forthcoming) used the average of contemporary transitions, we use the average of transitions which took place in the previous year. Formally, the first instrument is:

$$Z_{i,t}^1 = \sum_{i' \in r, i' \neq i} D_{i',t-1} / (n - 1) \quad (5)$$

Where:

r is the region of country i ;

n is the number of countries in the region of country i .

The second instrument is the weighted average of transitions having taken place two years before in a given region excluding the country of observation. The weight is the distance of the country's transition dummy to the regional average.¹⁵ This allows considering country specificities translating in the propensity of a country to catch the democratization wave or to miss it. Formally, the second variable is:

$$Z_{i,t}^2 = (\sum_{i' \in r, i' \neq i} D_{i',t-2} / (n - 1))X (D_{i,t-2} - \sum_{i' \in r, i' \neq i} D_{i',t-2} / (n - 1)) \quad (6)$$

The logic of the second variable follows the logic described in Nunn and Qian (2014). We multiply a region-specific variable by the propensity of a country to catch the regional wave of democratic transitions. The distance of a country to the average score of the region proxies this propensity. If a country does not catch the wave of transitions previously, it is imputed with a “malus” that is growing as the number of transitions in its region increases.

Compared to the semi-parametric estimates of previous section, the IV-estimates of this section not only control for pre-transitions observables as sections 5.1 and 5.2 do but also consider time-varying omitted variables. However, for the IV estimates to be reliable the instruments should be highly correlated with the variables to be instrumented, that is to be “strong”. They should also be uncorrelated with the disturbances of the equation of interest, which is to be “valid”. The Staiger and Stock (1997) ‘rule’ implies that the instruments are strong if the first-stage F-statistic of the regression of the variable to be instrumented on the

¹⁵ Lagged values are used in order to avoid endogeneity of the instrument. It also considers a possible delay between the beginning of a wave of democratic transitions in a region and its effect on a country.

instrument is above 10. The instruments are valid if the Hansen p-value is above 0.10 in each model of interest.

The IV estimates of Equation 1 result from the following equations:

$$\frac{FDI_{i,t}}{GDP_{i,t}} = \rho \frac{FDI_{i,t-1}}{GDP_{i,t-1}} + \beta D_{i,t} + \gamma A_{i,t} + \Gamma X'_{i,t} + \phi_t + \eta_i + \varepsilon_{i,t} \quad (7)$$

$$D_{i,t} = \rho \frac{FDI_{i,t-1}}{GDP_{i,t-1}} + \beta_{z1} Z^1_{i,t} + \beta_{z2} Z^2_{i,t} + \gamma A_{i,t} + \Gamma X'_{i,t} + \phi_t + \eta_i + \varepsilon_{i,t} \quad (8)$$

In order to estimate Equation 2, we use different lagged values of the instruments $Z^1_{i,t}$ and $Z^2_{i,t}$ as described in equation 9.

$$\frac{FDI_{i,t}}{GDP_{i,t}} = \rho \frac{FDI_{i,t-1}}{GDP_{i,t-1}} + \sum_{p=1}^5 \beta_p D^p_{i,t} + \gamma A_{i,t} + \Gamma X'_{i,t} + \phi_t + \eta_i + \varepsilon_{i,t} \quad (9)$$

$$D^p_{i,t} = \rho^p \frac{FDI_{i,t-1}}{GDP_{i,t-1}} + \sum_{l=-8}^{l=5} \beta_{z1,l}^p Z^1_{i,t-l} + \sum_{l=-9}^{l=5} \beta_{z2,l}^p Z^2_{i,t-l} + \gamma^p A_{i,t} + \Gamma^p X'_{i,t} + \phi_t^p + \eta_i^p + \varepsilon_{i,t}^p \quad (10)$$

Table 4 shows our results. The Hansen p-stat is above 0.10 in each model, the instruments are then valid and the results can have a causal interpretation. Moreover, the first stage F-stat of the instruments is above 10 for each of the dummy variables introduced in the models (even taken one by one in the model with several pre-transition and post-transition dummy). The instruments are strong and, then, predict well the democratic transition of a country.

*** INSERT TABLE 4 HERE***

The results in Table 4 are in line with previous estimates. In Column 4.1 and 4.2, the coefficients for $D_{i,t}$ are insignificant at usual levels. In specifications 4.3 and 4.4, when controlling for political risk, the coefficient of $D_{i,t}$ remains insignificant when considering the whole set of democratic transitions while the coefficient is significant at the ten-percent level when considering only consolidated transitions (Column 4.4). Hence it confirms that one should

account for both consolidation and political risk to observe an effect of democratic transitions on FDI. The effect outreaches 1.5 percent of GDP when controlling for $ICRG_{11}$ using the set of consolidated democratic transitions (Column 4.4). The results when splitting the dummy variables into several ones are less conclusive¹⁶. We cannot observe any specific timing without controlling for $ICRG_{11}$ in both cases. Using the whole set of democratic transitions, dummy variables $D_{i,t}^2$, $D_{i,t}^4$, $D_{i,t}^5$ are significant and positive, whereas dummy variables $D_{i,t}^2$, $D_{i,t}^3$, and $D_{i,t}^5$ are also significant and positive when considering only consolidated democratic transitions.

Overall, IV estimates confirm the positive effect democratic transitions have on FDI. In contrast to the OLS results, the set of all democratic transitions also have a positive effect on FDI once endogeneity has been addressed and political risk is controlled for. However, this effect does not appear when using a single post transition dummy variable. Local projections and propensity score matching also shows how taking the whole set of democratic transitions into account tempers the results obtained when using only the subset of consolidated democratic transitions.

6. Conclusion

Both democratic and undemocratic country leaders seem to believe that democracy attracts foreign investors. Our findings suggest that their belief is founded. To be sure, democratic transitions on average do not attract more foreign direct investment. Yet, this non-finding is not the result of an aversion of foreign investors for democracy per se. We observe that it is more likely an outcome of the risk that democratic transitions bring about. When we focus on consolidated democratic transitions, we indeed observe that they attract more FDI. The effect is even clearer when one directly controls for political risk. Our results confirm that low political risk and democracy both attract investors, and that their effects are independent of each other.

The results are robust to changing the set of control variables controlling for GDP per capita and schooling, to alternative codings of the variables capturing the transition, disaggregating political risk into several sub-components, and the exclusion of outliers. Moreover, local projections, propensity score matching, and IV estimates lend credence to a causal interpretation of the results.

¹⁶ A model with more dummy variables assumes a specific timing. It comes at a risk of muting the effect because of a smaller number of observations with value 1 for each dummy variable.

One may still wonder what lies behind the intrinsic effect of democratic transitions. Possible candidates are the integration into international and trade organizations that may foster the visibility of a country. Foreign investors may also care about their reputation. NGOs and human right activists may as well pressure firms. Testing those hypotheses is food for future research.

7. Tables

Table 1: Impact of democratic transitions on FDI inflows: baseline results

	(1.1) All	(1.2) Consolidated	(1.3) All	(1.4) Consolidated
$FDI_{i,t-1}$	0.410*** (4.962)	0.410*** (4.955)	0.410*** (4.955)	0.410*** (4.959)
$D_{i,t}$	0.390 (1.234)	0.585** (2.035)		
$D_{i,t}^1$			-0.153 (-0.852)	-0.244 (-1.243)
$D_{i,t}^2$			0.190 (0.518)	0.355 (0.935)
$D_{i,t}^3$			0.109 (0.268)	0.300 (0.981)
$D_{i,t}^4$			0.390 (0.878)	0.479 (1.171)
$D_{i,t}^5$			0.712 (1.364)	0.790* (1.676)
$A_{i,t}$	0.414 (1.381)	0.490* (1.745)	0.447 (1.429)	0.479* (1.666)
Constant	0.368 (1.236)	0.362 (1.242)	0.365 (1.178)	0.362 (1.213)
Observations	4,818	4,818	4,818	4,818
Number of countries	115	115	115	115
Adjusted R-squared	0.250	0.250	0.250	0.250

Robust t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Table 2: Impact of democratic transitions on FDI inflows: baseline results controlling for country risk

	(2.1)	(2.2)	(2.3)	(2.4)	(2.5)	(2.6)	(2.7)	(2.8)
	All	Consolidated	All	Consolidated	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.384*** (3.582)	0.381*** (3.552)	0.374*** (3.389)	0.373*** (3.377)	0.383*** (3.554)	0.381*** (3.519)	0.374*** (3.355)	0.372*** (3.335)
$D_{i,t}$	0.586 (1.173)	1.092** (2.063)	0.700 (1.469)	1.084** (2.246)				
$D_{i,t}^1$					-0.209 (-0.569)	0.0753 (0.240)	-0.0468 (-0.118)	0.268 (0.856)
$D_{i,t}^2$					0.582 (0.706)	1.289 (1.522)	0.892 (0.986)	1.539* (1.759)
$D_{i,t}^3$					0.285 (0.326)	1.082 (1.565)	0.543 (0.605)	1.225* (1.844)
$D_{i,t}^4$					0.896 (0.929)	1.450 (1.630)	1.047 (1.104)	1.513* (1.835)
$D_{i,t}^5$					1.061 (1.037)	1.611* (1.721)	1.108 (1.140)	1.572* (1.869)
$A_{i,t}$	0.0606 (0.126)	0.329 (0.638)	0.436 (0.901)	0.608 (1.215)	0.0921 (0.180)	0.273 (0.561)	0.416 (0.756)	0.524 (1.063)
ICRG ₁₁			0.0695* (1.884)	0.0679* (1.882)			0.0696* (1.803)	0.0697* (1.895)
Constant	0.403 (1.177)	0.264 (0.848)	-2.862 (-1.485)	-2.890 (-1.553)	0.384 (0.834)	0.212 (0.534)	-2.913 (-1.359)	-3.046 (-1.529)
Observations	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Number of countries	85	85	85	85	85	85	85	85
Adjusted R-squared	0.208	0.209	0.214	0.215	0.208	0.210	0.214	0.216

All regressions are run on a sample of countries for which the ICRG index is available, including those that do not control for the ICRG index. Robust t- statistics in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 3: Treatment effect (Results from local projections model)

	Average treatment effect from democratic transitions	-5 to -1 year	0 to 5 years	6 to 10 years	11 to 15 years	16 to 20 years
Not accounting for political risk	Average effect of all democratic transitions on FDI/GDP	0.07	-0.08	0.25	0.04	0.82**
	t-stat	(0.61)	(-0.49)	(1.10)	(0.24)	(2.04)
	Average effect of consolidated democratic transitions on FDI/GDP	0.07	0.07	0.50	0.10	1.36**
	t-stat	(0.48)	(0.33)	(1.56)	(0.56)	(2.47)
Accounting for political risk	Average effect of all democratic transitions on FDI/GDP	0.16	0.35	0.73**	0.32	1.44**
	t-stat	(0.92)	(1.36)	(2.16)	(1.56)	(2.44)
	Average effect of consolidated democratic transitions on FDI/GDP	-0.42	0.51	1.01**	0.27	2.03***
	t-stat	(-0.97)	(1.60)	(1.97)	(1.13)	(2.66)

Table 4: IV estimates

	(12.1) IV – All	(12.2) IV Consolidated	(12.3) – IV – All	(12.4) IV Consolidated	(12.5) – IV – All	(12.6) IV Consolidated	(12.7) – IV – All	(12.8) IV Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.410*** (4.982)	0.409*** (4.968)	0.372*** (3.374)	0.371*** (3.364)	0.315*** (3.714)	0.317*** (3.764)	0.207** (2.316)	0.209** (2.323)
$D_{i,t}$	0.518 (0.975)	0.708 (1.481)	1.393 (1.254)	1.518* (1.680)				
$D_{i,t}^1$					-0.214 (-0.0942)	-2.191 (-1.143)	-3.992 (-0.926)	-5.246 (-1.207)
$D_{i,t}^2$					0.628 (0.361)	1.987 (0.965)	12.11** (2.323)	12.31** (2.498)
$D_{i,t}^3$					-0.803 (-1.104)	-0.335 (-0.696)	3.280 (1.571)	2.934* (1.758)
$D_{i,t}^4$					0.000397 (0.000837)	0.0429 (0.0939)	4.088* (1.761)	2.750 (1.494)
$D_{i,t}^5$					0.0995 (0.149)	0.180 (0.274)	4.748* (1.844)	3.982* (1.765)
$A_{i,t}$	0.499 (1.222)	0.560 (1.642)	0.962 (1.000)	0.889 (1.251)	0.00428 (0.0116)	0.182 (0.628)	1.445 (1.356)	0.482 (0.554)
ICRG ₁₁			0.0708* (1.948)	0.0679* (1.924)			0.0944** (2.526)	0.0755** (2.136)
Observations	4,818	4,818	2,476	2,476	4,013	4,013	1,881	1,881
Number of countries	115	115	85	85	115	115	85	85
Hansen p-stat	0.666	0.797	0.122	0.125	0.820	0.963	0.773	0.804
First stage F stat	77.65	147.9	23.24	44.00				
D								
D ¹					22.69	30.14	11.08	12.28
D ²					31.48	28.57	20.04	15.52
D ³					29.72	25.85	13.03	12.04
D ⁴					18.81	15.96	18.17	16.23
D ⁵					86.64	94.82	28.06	28.71

Robust z-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Appendix

A.1 The literature

Table A1: The literature

Article	Dependent variable	Measure of democracy	Sample	Period of study	Impact of democracy on FDI
Rodrik (1996)	Manufacturing FDI by US majority-owned foreign affiliates 1982-89	Helliwell democracy indicator (transformation of the Freedom House indices of civil and political rights)	Cross-section of 39 countries	1982-1989	+
Harms and Ursprung (2002)	FDI flows/population	Freedom House indices of civil and political rights	Cross-section and panel of 62 developing and emerging countries	1989-1997	+
Biswas (2002)	FDI flows by non-bank US firms aggregated at the industry level	Democracy dummy defined by the Center for Institutional Reforms and the Informal Sector	Panel of 44 countries	1983-1990	+
Globerman and Shapiro (2003)	US FDI flows	Voice and Accountability index of the World Governance Indicators	Panel of 143 countries	1995-1997	+
Jensen (2003)	FDI flows/GDP	Polity III democracy index	Cross-section and panel of 79 countries	1990-1997	+
Ahlquist (2006)	FDI flows/GDP	Polity IV	Panel of 81 countries	1985-2002	+
Busse and Hefeker (2007)	FDI flows/population	International Country Risk Guide index of democratic accountability	Cross-section and panel of 83 developing countries	1984-2003	+
Choi and Samy (2008)	FDI flows/GDP and FDI flows	Index based on Polity IV	Panel of 90 countries	1985-2002	+
Guerin and Manzochi (2009)	Bilateral FDI flows	Democracy dummy based on the Polity IV index	Panel of bilateral flows between 14 developed source countries and 24 emerging and developing host countries	1992-2004	+
Patti and Navarra (2009)	FDI flows/GDP	Polity IV index	Panel of 66 countries	1980-2003	+
Choi (2009)	FDI flows level and FDI flows/GDP	Polity IV index	Panel of 53 countries	1982-1995	+
Vadlamannati (2012)	US firms FDI flows	Freedom House indices of civil and political rights Polity IV index Henisz's Political Constraints Indexes III and V	Panel of 101 developing countries	1997-2007	+
Kucera and Principi (2014)	US FDI flows to 15 industries	Freedom House indices of civil and political rights	Panel of 54 countries	1994-2010	+

		Polity IV index			
Resnick (2001)	FDI flows/World FDI flows	Polity III	Panel of 19 developing countries	1971-1993	-
Li and Resnick (2003)	FDI flows level	Polity IV index	Panel of 53 countries	1982-1995	-
Li (2009)	FDI flows	Polity IV index	Panel of 53 countries	1982-1995	-
Blanton and Blanton (2012)	US FDI stock	Polity IV index	Panel of 61 countries	1982-2007	-
Mathur and Singh (2013)	FDI flows	Based on Freedom House indexes of civil and political rights	Panel of 29 emerging and developing countries	1980-2000	-
Oneal (1994)	US FDI flows	Polity II index	Panel of 48 countries	1950-1985	Ns
Alesina and Dollar (2000)	FDI flows/GDP	Freedom House index	Panel of countries recipients of foreign aid	1970-1994	Ns
Noorbaksh et al. (2001)	FDI/GDP	Freedom House index	Panel of 36 developing countries	1984-1994	Ns
Yang (2007)	FDI flows, FDI flows/GDP, and FDI flows/population	Alvarez et al. (1996) binary variable	134 countries	1983-2002	Ns
Büthe and Milner (2008)	FDI/GDP	Alvarez et al. (1996) binary variable, Polity IV index, and Freedom House index	Panel of 122 developing countries	1970-2000	Ns
Kucera (2002)	FDI flows/World FDI flows	Freedom House index	127 countries	1993-1999	Ns
Busse (2004)	FDI flows/population	Freedom House index	69 developing countries	1972-2001	Negative before 1990, positive after 1990
Jakobsen and de Soysa (2006)	FDI flows	Polity IV index and Freedom House index	Panel of 98 countries	1984-2001	Sensitive to sample selection
Adam and Filippaios (2007)	US FDI flows/GDP	Freedom House index	Panel of 105 countries	1989-1997	Humpshaped
Kolstad and Villanger (2008)	Industry level FDI flows/population	International Country Risk Guide index of democratic accountability	Panel of 57 countries	1989-2000	Positive in developing countries only
Asiedu and Lien (2011)	FDI flows/GDP	Polity IV index, Freedom House index, and International Country Risk Guide index of democratic accountability	Panel of 112 developing countries	1982-2007	Conditional on natural resources
Berden et al. (2014)	Bilateral FDI flows	Voice and Accountability index of the World Governance Indicators	Panel of bilateral flows between 28 OECD source countries and 124 host countries	1998-2004	No effect on the volume of FDI but a positive effect on the probability to be a host country

+: The paper reports a positive impact of democracy on FDI; -: The paper reports a negative impact of democracy on FDI; ns: The paper reports an insignificant impact of democracy on FDI.

A.2 Summary statistics

Table A2: Summary statistics

VARIABLES	(1) N	(2) Mean	(3) Sd	(4) Min	(5) Max
FDI/GDP	4818	2.46	5.40	-65.41	90.45
FDI	4818	1096.06	4424.26	-7120.02	74782.91
ICRG11	2,476	53.64	11.43	8.583	77.04
Law and Order	2,476	2.99	1.164133	0	6
Corruption	2,476	2.40	0.96	0	6
Internal Conflict	2,476	7.97	2.38	0	12
External Conflict	2,476	9.22	2.13	0	12
Government Stability	2,476	7.42	2.22	0	12
Socioeconomic conditions	2,476	4.66	1.86	0	10.08
Religious tensions	2,476	4.27	1.41	0	6
Military in Politics	2,476	2.93	1.62	0	6
Investment conditions	2,476	6.58	2.19	0	11.5
Bureaucracy	2,476	1.62	0.91	0	4
Ethnic tensions	2,476	3.65	1.43	0	6
GDP per capita	4290	2455.39	3325.99	68.57	24,566
Schooling	3209	45.56	28.97	0	124.3
Democratic History	4578	2.74	6.32	0	20

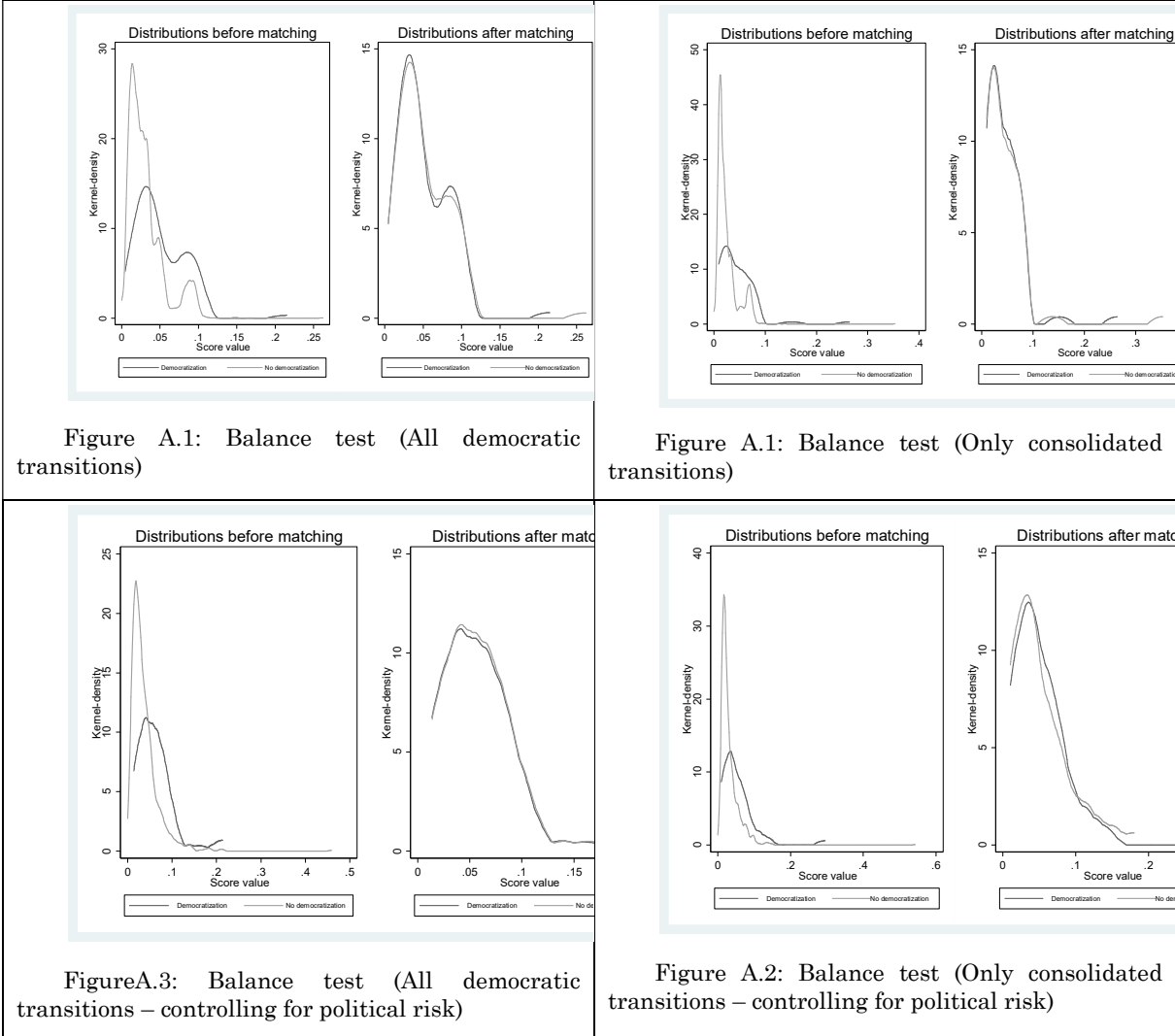
A.3 Countries in the sample

Table A3: Countries in the sample

<u>Country</u>	<u>Code</u>	<u>Demo</u>	<u>Reversal</u>	<u>Country</u>	<u>Code</u>	<u>Demo</u>	<u>Reversal</u>	<u>Country</u>	<u>Code</u>	<u>Demo</u>	<u>Reversal</u>
Afghanistan	AFG	None	None	Guinea-Bissau	GNB	1994, 1999, 2005 and 2014	1998, 2003 and 2012	Oman	OMN	None	None
Angola	AGO	None	None	Equatorial Guinea	GNQ	None	None	Pakistan	PAK	1972, 1988 and 2008	1977 and 1999
Argentina	ARG	1973 and 1983	1976	Grenada	GRD	1984	1979	Panama	PAN	1994	1968
Armenia	ARM	1991 and 1998	1996	Guatemala	GTM	1966 and 1986	1974	Peru	PER	1963, 1980 and 1993	1962, 1968 and 1992
Azerbaijan	AZE	1992	1993	Guyana	GUY	1992	1991, 2000 and 2010	Philippines	PHL	1987	1965
Burundi	BDI	2003	None	Honduras	HND	1982	None	Papua New Guinea	PNG	None	None
Benin	BEN	1991	None	Haiti	HTI	1990, 1994 and 2006	1991, 2000 and 2010	Korea, Dem. Rep.	PRK	None	None
Burkina Faso	BFA	1977	1980	Indonesia	IDN	1999	None	Paraguay	PRY	1993	None
Bangladesh	BGD	1991 and 2009	1974 and 2007	India	IND	None	None	Russian Federation	RUS	1993	2004
Bahrain	BHR	None	None	Iran, Islamic Rep.	IRN	None	None	Rwanda	RWA	None	None
Belize	BLZ	None	None	Iraq	IRQ	None	None	Saudi Arabia	SAU	None	None
Bolivia	BOL	1982	None	Jamaica	JAM	None	None	Sudan	SDN	1965 and 1986	1969 and 1989
Brazil	BRA	1985	1964	Jordan	JOR	None	None	Senegal	SEN	2000	None
Barbados	BRB	None	None	Kazakhstan	KAZ	None	None	Sierra Leone	SLE	1996 and 2001	1967 and 1997
Bhutan	BTN	2008	None	Kenya	KEN	2002	None	El Salvador	SLV	1982	None
Botswana	BWA	None	None	Kyrgyz Republic	KGZ	2000 and 2010	2009	Somalia	SOM	2012	1969
Central African Republic	CAF	1993	2003 and 2013	Cambodia	KHM	1993	1995	Suriname	SUR	1991	1980 and 1990
Chile	CHL	1990	None	Korea, Rep.	KOR	1988	1961	Swaziland	SWZ	None	None
Cote d'Ivoire	CIV	2000	2002	Lao PDR	LAO	None	None	Syrian Arab Republic	SYR	None	None
Cameroon	CMR	None	None	Lebanon	LBN	2005	1965	Chad	TCD	None	None
Congo, Dem. Rep.	COD	None	None	Liberia	LBR	2004	None	Togo	TGO	None	None
Congo, Rep.	COG	1992	1963 and 1997	Libya	LBY	None	2014	Thailand	THA	1974, 1978, 1992 and 2008	1976, 1991, 2006 and 2014
Colombia	COL	None	None	Sri Lanka	LKA	None	None	Tajikistan	TJK	None	None
Comoros	COM	1990, 1996, 2002	1976, 1995 and 1999	Lesotho	LSO	1993 and 1999	1998	Turkmenistan	TKM	None	None
Cape Verde	CPV	1991	None	Morocco	MAR	None	None	Trinidad and Tobago	TTO	None	None
Costa Rica	CRI	None	None	Moldova	MDA	1994	None	Tunisia	TUN	2014	None
Djibouti	DJI	1999	2010	Madagascar	MDG	1993	2009	Turkey	TUR	1964, 1973 and 1983	1971 and 1980
Dominican Republic	DOM	1978	None	Mexico	MEX	1997	None	Tanzania	TZA	None	None
Algeria	DZA	None	None	Mali	MLI	1992 and 2013	None	Uganda	UGA	1980	1985
Ecuador	ECU	1979	1961	Myanmar	MMR	None	1962	Uruguay	URY	1985	1972
Egypt, Arab Rep.	EGY	2012	2013	Mongolia	MNG	1993	None	Uzbekistan	UZB	None	None
Eritrea	ERI	None	None	Mozambique	MOZ	1994	None	Venezuela, RB	VEN	None	2009
Ethiopia	ETH	1995	2010	Mauritania	MRT	2007	2008	Vietnam	VNM	None	None
Fiji	FJI	1990	2006	Mauritius	MUS	None	None	Yemen, Rep.	YEM	None	2014
Gabon	GAB	None	None	Malawi	MWI	1994	None	South Africa	ZAF	1994	None
Georgia	GEO	1995	None	Malaysia	MYS	None	None	Zambia	ZMB	1991	None
Ghana	GHA	1970, 1979 and 1996	1972 and 1981	Niger	NER	1991, 1999 and 2010	1996 and 2009	Zimbabwe	ZWE	1978	1987
Guinea	GIN	2010	None	Nigeria	NGA	1979 and 1999	1966 and 1984				
Gambia, The	GMB	None	1994	Nepal	NPL	1991 and 2006	2002				

A.4 Propensity score matching (Samples balancing)

Figure A1: Samples balancing



A5. Robustness checks

Adding covariates Table A4 replicates the baseline results of Tables 1 and 2 while controlling for GDP per capita. The coefficient of GDP per capita is negative and significant at the ten-percent level irrespective of the specification, which can be explained by the fact that the left-hand side variable is the ratio of FDI to GDP. More importantly, the main findings are unaffected. Specifically, we can find no effect of democratic transitions when all transitions are pooled together (Columns 4.1, 4.3, 4.5, and 4.7). However, we observe that transition dummies bear a positive sign when they are defined over consolidated transitions (Columns A4.2, A4.4, A4.5, and A4.8). Again, the effect of transitions appears earlier and is larger when political risk is controlled for (Columns A4.6 and A4.8) than when it is not (Columns A4.2 and A4.4).

Specifically, the coefficient of $D_{i,t}$ is significant at the five-percent level in both Columns A4.2 and A4.6, and is larger in the latter. When decomposing the effect into different sub periods, the positive effect of consolidated democratic transitions does not appear before 6 years (Column A4.4) when political risk is not controlled for. When political risk is controlled for (Column A4.8) the impact of consolidated democratic transitions appears in the transition period and lasts for the two following three-year periods, as $D_{i,t}^2$, $D_{i,t}^3$, and $D_{i,t}^4$ now bear a significantly positive sign, in addition to $D_{i,t}^5$.

Table A4: Adding covariates – Controlling for development

	(A4.1)	(A4.2)	(A4.3)	(A4.4)	(A4.5)	(A4.6)	(A4.7)	(A4.8)
	All	Consolidated	All	Consolidated	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.390*** (4.693)	0.390*** (4.685)	0.390*** (4.687)	0.389*** (4.690)	0.371*** (3.284)	0.370*** (3.272)	0.372*** (3.268)	0.369*** (3.235)
$D_{i,t}$	0.339 (1.127)	0.564** (1.995)			0.595 (1.261)	0.995** (2.042)		
$D_{i,t}^1$			-0.195 (-1.064)	-0.318* (-1.666)			-0.251 (-0.655)	0.175 (0.544)
$D_{i,t}^2$			0.114 (0.301)	0.315 (0.823)			0.623 (0.685)	1.463* (1.668)
$D_{i,t}^3$			0.0147 (0.0373)	0.256 (0.843)			0.259 (0.291)	1.151* (1.729)
$D_{i,t}^4$			0.319 (0.711)	0.440 (1.067)			0.793 (0.855)	1.434* (1.769)
$D_{i,t}^5$			0.710 (1.390)	0.826* (1.802)			0.915 (0.955)	1.557* (1.865)
$A_{i,t}$	0.270 (0.878)	0.372 (1.246)	0.320 (1.050)	0.384 (1.340)	0.386 (0.795)	0.589 (1.142)	0.345 (0.633)	0.580 (1.169)
$GDP/Capita$	-0.140* (-1.802)	-0.135* (-1.759)	-0.146** (-1.999)	-0.142* (-1.934)	-0.279* (-1.975)	-0.264* (-1.908)	-0.285** (-2.138)	-0.252* (-1.984)
ICRG ₁₁					0.0777* (1.888)	0.0763* (1.892)	0.0763* (1.779)	0.0775* (1.896)
Constant	0.944** (2.353)	0.933** (2.381)	0.962** (2.326)	0.947** (2.384)	-1.143 (-0.551)	-1.354 (-0.679)	-1.183 (-0.479)	-1.712 (-0.751)
Observations	4,290	4,290	4,290	4,290	2,318	2,318	2,318	2,318
Number of countries	112	112	112	112	82	82	82	82
Adjusted R-squared	0.223	0.224	0.224	0.224	0.213	0.214	0.213	0.215

Robust t-statistics in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Table A5 reports the outcome of regressions controlling for the evolution of schooling. We observe that schooling is significant at the ten-percent level only when the $ICRG_{11}$ is not controlled for. It bears a negative sign, which may be surprising. However, one should remind that we already control for country fixed effects. Therefore, what we measure is not the impact of education on FDI, but the residual effect of annual variations of primary schooling, once average primary schooling has been controlled for by country fixed effects. The observed negative effect does therefore not imply that education is detrimental to FDI.

What is important here is that the coefficients of democratic transitions are again similar to the baseline results. We find no effect of transitions on FDI inflows when considering the whole set of democratic transitions (Columns A5.1, A5.3, A5.5, and A5.7), but observe that consolidated democratic transitions have one. Moreover, controlling for the $ICRG_{11}$ index speeds the effect of consolidated transitions up. The coefficient of $D_{i,t}$ bears a positive sign in Column A5.2 and increases when the $ICRG_{11}$ index is controlled for in Column A5.6. Like before, when the impact of democratic transitions is decomposed, it does not appear before six years (Column A5.4) unless $ICRG_{11}$ is controlled for.

Table A5: Adding covariate – Controlling for human capital

	(A5.1)	(A5.2)	(A5.3)	(A5.4)	(A5.5)	(A5.6)	(A5.7)	(A5.8)
	All	Consolidated	All	Consolidated	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.510*** (8.575)	0.509*** (8.601)	0.508*** (8.591)	0.508*** (8.599)	0.502*** (5.410)	0.501*** (5.395)	0.504*** (5.462)	0.500*** (5.409)
$D_{i,t}$	0.333 (1.146)	0.622** (2.240)			0.342 (0.834)	0.999* (1.709)		
$D_{i,t}^1$			-0.141 (-0.699)	-0.259 (-1.256)			-0.120 (-0.287)	0.268 (0.724)
$D_{i,t}^2$			-0.176 (-0.544)	0.0282 (0.102)			0.0927 (0.136)	1.010** (2.144)
$D_{i,t}^3$			-0.150 (-0.320)	0.249 (0.862)			-0.441 (-0.464)	0.865* (1.696)
$D_{i,t}^4$			-0.0218 (-0.0728)	0.150 (0.576)			-0.106 (-0.187)	0.729* (1.720)
$D_{i,t}^5$			0.556 (1.335)	0.738** (1.991)			0.321 (0.517)	1.158** (2.158)
$A_{i,t}$	0.420 (1.492)	0.564* (1.908)	0.385 (1.397)	0.512* (1.836)	0.304 (0.559)	0.763 (1.042)	0.0300 (0.0682)	0.441 (0.800)
Schooling	-0.0131* (-1.732)	-0.0125* (-1.692)	-0.0143* (-1.898)	-0.0139* (-1.875)	-0.0153 (-1.645)	-0.0144 (-1.557)	-0.0148 (-1.603)	-0.0134 (-1.440)
ICRG ₁₁					0.0436** (2.309)	0.0437** (2.334)	0.0399** (2.150)	0.0445** (2.334)
Constant	-1.087 (-0.361)	-1.324 (-0.440)	-1.155 (-0.383)	-1.314 (-0.435)	-4.954 (-0.907)	-5.488 (-0.995)	-4.703 (-0.864)	-5.669 (-1.037)
Observations	3,209	3,209	3,209	3,209	1,558	1,558	1,558	1,558
Number of countries	112	112	112	112	83	83	83	83
Adjusted R-squared	0.366	0.367	0.366	0.367	0.315	0.317	0.314	0.316

Robust t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Excluding outliers

The results reported in Table A6 replicate those of Table 1 but exclude outliers. Columns A6.1 and A6.2 control for the single post-transition dummy $D_{i,t}$. We still observe that consolidated democratic transitions have a positive effect on FDI. The effect is significant at the five-percent level. A surprising result is that we can now also observe a positive effect of democratic transitions in general. However, it is only marginally significant at the ten-percent level, meaning that the effect of democratic transitions is less precisely measured and/or more heterogeneous than the effect of consolidated transitions, in line with our previous results.

In Columns A6.3 and A6.4, we consider sub-periods around transitions. As in the baseline results, we observe no impact of democratic transitions in general: in Column A6.3, no transition dummy is statistically insignificant at usual levels. However, consolidated democratic transitions attract FDI: the coefficient for $D_{i,t}^5$ is significant at the ten-percent level and has a magnitude comparable to baseline results.

Table A6: Excluding outliers

	(A6.1)	(A6.2)	(A6.3)	(A6.4)
	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.288*** (5.009)	0.288*** (5.007)	0.288*** (5.045)	0.288*** (5.036)
$D_{i,t}$	0.434* (1.790)	0.526** (2.225)		
$D_{i,t}^1$			-0.235 (-1.375)	-0.275 (-1.243)
$D_{i,t}^2$			-0.0319 (-0.152)	0.126 (0.498)
$D_{i,t}^3$			0.411 (1.427)	0.493 (1.577)
$D_{i,t}^4$			0.181 (0.703)	0.224 (0.876)
$D_{i,t}^5$			0.527 (1.561)	0.564* (1.755)
$A_{i,t}$	0.376 (1.233)	0.389 (1.390)	0.389 (1.312)	0.357 (1.273)
Constant	0.863*** (3.924)	0.874*** (4.065)	0.884*** (4.070)	0.893*** (4.157)
Observations	4,742	4,742	4,742	4,742
Number of countries	115	115	115	115
Adjusted R-squared	0.367	0.368	0.367	0.368

Robust t-statistics in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Alternative coding of the transition period

Table A7 presents the results of estimating Equation 2 when the dummy variable D_{it}^5 is split in six three-year dummies.

Table A7: Alternative coding of the transition period: decomposing the long run

	(A7.1)	(A7.2)	(A7.3)	(A7.4)
	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.408*** (4.980)	0.408*** (4.983)	0.372*** (3.381)	0.369*** (3.358)
$D_{i,t}^1$	-0.144 (-0.823)	-0.218 (-1.116)	0.0220 (0.0599)	0.373 (1.259)
$D_{i,t}^2$	0.120 (0.380)	0.377 (1.006)	0.809 (1.062)	1.656* (1.924)
$D_{i,t}^3$	0.183 (0.513)	0.329 (1.091)	0.799 (1.046)	1.386** (2.141)
$D_{i,t}^4$	0.415 (1.006)	0.512 (1.280)	1.210 (1.376)	1.692** (2.100)
$D_{i,t}^6$	0.968 (1.407)	1.018 (1.518)	1.305 (1.163)	1.708 (1.575)
$D_{i,t}^7$	0.128 (0.356)	0.190 (0.548)	0.714 (1.154)	1.161** (2.009)
$D_{i,t}^8$	0.745 (1.561)	0.829* (1.783)	1.374 (1.611)	1.857** (2.278)
$D_{i,t}^9$	1.707* (1.779)	1.891* (1.918)	2.335* (1.830)	2.970** (2.326)
$D_{i,t}^{10}$	1.029 (1.629)	1.162* (1.764)	1.628 (1.562)	2.271** (2.117)
$D_{i,t}^{11}$	0.310 (0.588)	0.415 (0.810)	0.946 (1.028)	1.509* (1.723)
$A_{i,t}$	0.497 (1.570)	0.493* (1.744)	0.603 (1.030)	0.591 (1.178)
ICRG ₁₁			0.0703* (1.809)	0.0694* (1.878)
Constant	0.361 (1.172)	0.362 (1.213)	-3.015 (-1.404)	-3.079 (-1.532)
Observations	4,818	4,818	2,476	2,476
Number of countries	115	115	85	85
Adjusted R-squared	0.251	0.251	0.215	0.217

Robust t-statistics in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

The only dummy variable that is significant when considering all democratic transitions together is D_{it}^9 (Column A7.1), implying that democratic transitions in general take fifteen years to affect FDI. Column A7.2 shows that the effect of consolidated democratic transitions materializes around twelve to twenty-one years after the transitionA7.. Regressions A7.3 and

A7.4 control for political risk. Once more, the effect of consolidated democratic transitions is clearer than the effect of transitions in general and starts earlier. Variables D_{it}^2 to D_{it}^{11} .

Table A8 Reports the results of estimating Equations 1 and 2 when splitting the dummy variables coding the short and medium run after the transition, D_{it}^3 and D_{it}^4 , into single-year dummy variables.

Table A8: Alternative coding of the transition period: decomposing the short and medium run

	(A8.1)	(A8.2)	(A8.3)	(A8.4)
	All	Consolidated	All	Consolidated
$FDI_{i,t-1}/GDP_{i,t-1}$	0.410*** (4.948)	0.410*** (4.952)	0.374*** (3.345)	0.372*** (3.328)
D_{it}^1	-0.144 (-0.812)	-0.243 (-1.238)	-0.00923 (-0.0242)	0.273 (0.880)
D_{it}^2	0.188 (0.541)	0.355 (0.935)	0.920 (1.067)	1.541* (1.764)
Demo +1	0.0896 (0.143)	0.379 (0.924)	0.301 (0.257)	1.173 (1.520)
Demo +2	0.0784 (0.186)	0.312 (0.818)	0.879 (0.964)	1.492** (2.081)
Demo +3	0.330 (1.056)	0.211 (0.655)	0.886 (1.205)	1.027 (1.512)
Demo +4	0.215 (0.519)	0.325 (0.788)	0.901 (0.972)	1.347 (1.629)
Demo +5	0.790 (1.092)	0.864 (1.195)	1.476 (1.251)	1.916* (1.712)
Demo+6	0.180 (0.280)	0.242 (0.372)	0.911 (0.724)	1.274 (1.075)
D_{it}^5	0.732 (1.436)	0.790* (1.674)	1.189 (1.260)	1.572* (1.865)
A_{it}	0.463 (1.467)	0.479* (1.666)	0.478 (0.856)	0.525 (1.065)
ICRG ₁₁			0.0701* (1.819)	0.0696* (1.897)
Constant	0.359 (1.165)	0.358 (1.204)	-2.985 (-1.398)	-3.048 (-1.531)
Observations	4,818	4,818	2,476	2,476
Number of countries	115	115	85	85
Adjusted R-squared	0.249	0.250	0.213	0.215

Robust t-statistics in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Those results are in line with the baseline ones. When considering the whole set of democratic transitions, we observe no effect of the democratic transition dummy variable (Column A8.1). When we only take consolidated transitions into account, the coefficient of variable D_{it}^5 is significant at the ten-percent level and equals its value in the baseline results

(Column A8.2). After controlling for political risk, results are again comparable to baseline results.

Decomposing political risk

Tables A9a to A10b report the results of regressions controlling for one component of the ICRG₁₁ index at a time. Tables A9a and A9b specifically report the results of those regressions for the whole set of democratic transitions and Tables A10a and A10b for the subset of consolidated democratic transitions.

Table A9a reports the results obtained when using a single post-transition dummy and the whole set of democratic transitions. The law and order, government stability, and ethnic tensions components of the ICRG₁₁ index bear a positive coefficient that is statistically significant at standard levels, suggesting that they are the dimensions of political risk that matter the most to foreign investors.

Like before $D_{i,t}$ is statistically insignificant in every column. Table A9b reports the results obtained when using a model with five impulse dummies, government stability and ethnic tensions still bear a positive sign, but law and order is now statistically insignificant. Again, we cannot observe any significant effect of democratic transitions.

Tables A10a and A10b consider the subset of consolidated democratic transitions, while controlling for each dimension of the ICRG₁₁ index. In Table A10b like in Table A10a, law and order, government stability, and ethnic tensions exhibit a positive and significant sign. In contrast to Table A10a, the coefficient of $D_{i,t}$ is significant at the five-percent level in each column. Table A10b reports the result of separating the effect of democratic transitions into five different sub periods. Again, law and order, government stability, and ethnic tensions are the dimensions of the ICRG₁₁ index that significantly affect FDI. However, unlike in Table A10b, we observe that the coefficient of variable $D_{i,t}^5$ is now positive and significant at the ten-percent level in all specifications. Its magnitude reaches levels comparable to the ones in baseline results. $D_{i,t}^3$ is significant and positive when controlling for law and order, government stability, religious tensions and ethnic tension. $D_{i,t}^4$ is positive when controlling for law and order, corruption, religious conflict, ethnic conflict, internal conflict, government stability and military in politics.

Table A9a: Controlling for ICRG components (All democratic transitions – pre- and post-Democratic transitions periods)

	(A9a.1)	(A9a.2)	(A9a.3)	(A9a.4)	(A9a.5)	(A9a.6)	(A9a.7)	(A9a.8)	(A9a.9)	(A9a.10)	(A9a.11)
	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG
	Law	Corruption	Int. Conflict	Ext. Conflict	Gov Stability	Socioeco conditions	Religious tensions	Military in politics	Investment profile	Ethnic tensions	Bureaucracy
$FDI_{i,t-1}/GDP_{i,t-1}$	0.378*** (3.476)	0.383*** (3.547)	0.380*** (3.477)	0.381*** (3.524)	0.374*** (3.429)	0.382*** (3.532)	0.383*** (3.580)	0.382*** (3.535)	0.381*** (3.540)	0.380*** (3.521)	0.383*** (3.576)
$D_{i,t}$	0.669 (1.306)	0.573 (1.169)	0.621 (1.262)	0.512 (1.173)	0.688 (1.458)	0.682 (1.248)	0.632 (1.251)	0.623 (1.240)	0.600 (1.216)	0.626 (1.274)	0.589 (1.179)
$A_{i,t}$	0.244 (0.486)	0.100 (0.209)	0.212 (0.433)	0.0732 (0.171)	0.117 (0.256)	0.169 (0.345)	0.141 (0.304)	0.332 (0.609)	0.148 (0.320)	0.0614 (0.135)	0.0766 (0.162)
ICRG component	0.442* (1.677)	0.140 (0.763)	0.166 (1.381)	0.182 (1.476)	0.389** (2.598)	0.121 (1.035)	0.208 (1.483)	0.211 (1.412)	0.135 (1.482)	0.357* (1.872)	0.0452 (0.320)
Constant	-0.730 (-0.800)	0.0279 (0.0435)	-0.677 (-0.689)	-0.898 (-0.810)	-1.257* (-1.841)	-0.246 (-0.292)	-0.452 (-0.582)	-0.233 (-0.345)	-0.218 (-0.355)	-0.752 (-0.872)	0.332 (0.827)
Observations	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Number of countries	85	85	85	85	85	85	85	85	85	85	85
Adjusted R-squared	0.211	0.208	0.210	0.210	0.216	0.208	0.208	0.209	0.209	0.210	0.208

Robust t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table A9b: Controlling for ICRG components (All democratic transitions – Time-varying effect)

	(A9b.1)	(A9b.2)	(A9b.3)	(A9b.4)	(A9b.5)	(A9b.6)	(A9b.7)	(A9b.8)	(A9b.9)	(A9b.10)	(A9b.11)
	ICRG Law	ICRG Corruption	ICRG Int. Conflict	ICRG Ext. Conflict	ICRG Gov Stability	ICRG Socioeco conditions	ICRG Religious tensions	ICRG Military politics	ICRG in Investment profile	ICRG Ethnic tensions	ICRG Bureaucrac y
$FDI_{i,t-1}/GDP_{i,t-1}$	0.378*** (3.440)	0.382*** (3.521)	0.379*** (3.435)	0.381*** (3.494)	0.373*** (3.402)	0.382*** (3.510)	0.382*** (3.553)	0.381*** (3.508)	0.381*** (3.513)	0.380*** (3.485)	0.383*** (3.549)
$D_{i,t}^1$	-0.0712 (-0.178)	-0.190 (-0.505)	-0.0641 (-0.155)	-0.189 (-0.486)	-0.213 (-0.610)	-0.214 (-0.592)	-0.210 (-0.561)	-0.152 (-0.394)	-0.162 (-0.434)	-0.137 (-0.375)	-0.209 (-0.566)
$D_{i,t}^2$	0.753 (0.843)	0.608 (0.730)	0.770 (0.854)	0.585 (0.704)	0.747 (0.938)	0.628 (0.744)	0.617 (0.729)	0.689 (0.796)	0.649 (0.780)	0.766 (0.881)	0.583 (0.704)
$D_{i,t}^3$	0.471 (0.507)	0.287 (0.332)	0.402 (0.449)	0.211 (0.253)	0.415 (0.505)	0.379 (0.411)	0.341 (0.380)	0.364 (0.410)	0.335 (0.382)	0.437 (0.486)	0.287 (0.326)
$D_{i,t}^4$	1.009 (1.010)	0.895 (0.945)	0.977 (0.998)	0.791 (0.886)	1.012 (1.126)	0.984 (0.966)	0.947 (0.959)	0.931 (0.969)	0.912 (0.954)	0.946 (0.992)	0.898 (0.926)
$D_{i,t}^5$	1.166 (1.107)	1.039 (1.036)	1.153 (1.106)	0.991 (1.024)	1.153 (1.194)	1.114 (1.059)	1.076 (1.047)	1.041 (1.047)	1.037 (1.031)	1.138 (1.108)	1.059 (1.036)
$A_{i,t}$	0.264 (0.474)	0.126 (0.242)	0.246 (0.449)	0.105 (0.220)	0.125 (0.264)	0.171 (0.319)	0.156 (0.304)	0.315 (0.533)	0.156 (0.311)	0.0941 (0.195)	0.0947 (0.186)
ICRG Component	0.440 (1.601)	0.129 (0.689)	0.170 (1.332)	0.181 (1.499)	0.392** (2.561)	0.116 (0.960)	0.201 (1.405)	0.196 (1.292)	0.127 (1.350)	0.365* (1.770)	0.00888 (0.0581)
Constant	-0.770 (-0.705)	0.0350 (0.0448)	-0.754 (-0.641)	-0.909 (-0.746)	-1.550** (-2.008)	-0.233 (-0.235)	-0.440 (-0.478)	-0.212 (-0.262)	-0.288 (-0.368)	-0.820 (-0.779)	0.370 (0.692)
Observations	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Number of countries	85	85	85	85	85	85	85	85	85	85	85
Adjusted R-squared	0.211	0.208	0.210	0.210	0.217	0.209	0.209	0.209	0.209	0.210	0.208

Robust t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

Table A10a: Controlling for ICRG components (Consolidated democratic transitions – pre and post Democratic transitions periods)

	(A10a.1)	(A10a.2)	(A10a.3)	(A10a.4)	(A10a.5)	(A10a.6)	(A10a.7)	(A10a.8)	(A10a.9)	(A10a.10)	(9a.11)
	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG
	Law	Corruption	Int. Conflict	Ext. Conflict	Gov Stability	Socioeco conditions	Religious tensions	Military in politics	Investment profile	Ethnic tensions	Bureaucracy
$FDI_{i,t-1}/GDP_{i,t-1}$	0.376*** (3.451)	0.380*** (3.520)	0.377*** (3.459)	0.379*** (3.500)	0.372*** (3.412)	0.379*** (3.502)	0.380*** (3.551)	0.379*** (3.514)	0.379*** (3.515)	0.378*** (3.494)	0.381*** (3.547)
$D_{i,t}$	1.137** (2.141)	1.076** (2.069)	1.057** (2.108)	0.994** (2.072)	1.078** (2.225)	1.181** (2.091)	1.147** (2.163)	1.073** (2.088)	1.069** (2.050)	1.113** (2.150)	1.090** (2.060)
$A_{i,t}$	0.480 (0.905)	0.366 (0.706)	0.427 (0.835)	0.331 (0.697)	0.300 (0.613)	0.427 (0.822)	0.414 (0.834)	0.547 (0.979)	0.388 (0.774)	0.314 (0.631)	0.338 (0.662)
ICRG Component	0.441* (1.698)	0.132 (0.730)	0.159 (1.354)	0.174 (1.428)	0.383** (2.618)	0.130 (1.127)	0.221 (1.584)	0.198 (1.382)	0.129 (1.423)	0.357* (1.897)	0.0334 (0.234)
Constant	-0.855 (-0.975)	-0.0891 (-0.143)	-0.751 (-0.803)	-0.970 (-0.910)	-1.322* (-1.828)	-0.430 (-0.531)	-0.647 (-0.883)	-0.316 (-0.503)	-0.303 (-0.491)	-0.884 (-1.062)	0.213 (0.565)
Observations	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Number of countries	85	85	85	85	85	85	85	85	85	85	85
Adjusted R-squared	0.212	0.209	0.211	0.211	0.217	0.210	0.210	0.210	0.210	0.212	0.209

Robust t-statistics in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Table A10b: Controlling for ICRG components (Consolidated democratic transitions – Time-varying effect)

	(A10b.1)	(A10b.2)	(A10b.3)	(A10b.4)	(A10b.5)	(A10b.6)	(A10b.7)	(A10b.8)	(A10b.9)	(A10b.10)	(A10b.11)
	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG	ICRG
	Law	Corruption	Int. Conflict	Ext. Conflict	Gov Stability	Socioeco conditions	Religious tensions	Military in politics	Investment profile	Ethnic tensions	Bureaucracy
$FDI_{i,t-1}/GDP_{i,t-1}$	0.375*** (3.406)	0.380*** (3.488)	0.377*** (3.419)	0.379*** (3.464)	0.372*** (3.384)	0.379*** (3.475)	0.380*** (3.516)	0.379*** (3.477)	0.379*** (3.483)	0.377*** (3.451)	0.381*** (3.515)
$D_{i,t}^1$	0.277 (0.868)	0.101 (0.318)	0.175 (0.530)	0.0971 (0.305)	0.0282 (0.0870)	0.0848 (0.280)	0.131 (0.426)	0.165 (0.510)	0.118 (0.365)	0.178 (0.590)	0.0768 (0.241)
$D_{i,t}^2$	1.496 (1.629)	1.319 (1.544)	1.372 (1.604)	1.267 (1.536)	1.302 (1.654)	1.346 (1.555)	1.384 (1.581)	1.399 (1.588)	1.331 (1.574)	1.510* (1.689)	1.290 (1.518)
$D_{i,t}^3$	1.252* (1.683)	1.082 (1.594)	1.093 (1.657)	0.982 (1.571)	1.073* (1.736)	1.178 (1.596)	1.189* (1.666)	1.121 (1.628)	1.097 (1.603)	1.234* (1.727)	1.084 (1.558)
$D_{i,t}^4$	1.554* (1.706)	1.448* (1.665)	1.441* (1.690)	1.332 (1.649)	1.447* (1.828)	1.541 (1.650)	1.541* (1.686)	1.462* (1.681)	1.438 (1.645)	1.493* (1.713)	1.452 (1.627)
$D_{i,t}^5$	1.708* (1.790)	1.588* (1.736)	1.616* (1.781)	1.527* (1.758)	1.586* (1.862)	1.663* (1.737)	1.661* (1.756)	1.566* (1.756)	1.561* (1.706)	1.684* (1.804)	1.607* (1.718)
$A_{i,t}$	0.416 (0.803)	0.306 (0.620)	0.377 (0.757)	0.284 (0.622)	0.248 (0.551)	0.345 (0.692)	0.348 (0.724)	0.475 (0.877)	0.319 (0.672)	0.248 (0.541)	0.277 (0.571)
ICRG Component	0.460* (1.697)	0.133 (0.731)	0.164 (1.382)	0.173 (1.462)	0.384*** (2.651)	0.127 (1.068)	0.230 (1.567)	0.202 (1.409)	0.126 (1.356)	0.386* (1.931)	0.0136 (0.0885)
Constant	-0.979 (-0.957)	-0.148 (-0.206)	-0.850 (-0.818)	-1.020 (-0.891)	-1.451** (-2.077)	-0.461 (-0.501)	-0.740 (-0.860)	-0.389 (-0.542)	-0.442 (-0.609)	-1.053 (-1.077)	0.191 (0.408)
Observations	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Number of countries	85	85	85	85	85	85	85	85	85	85	85
Adjusted R-squared	0.213	0.210	0.212	0.212	0.218	0.210	0.210	0.211	0.210	0.212	0.210

Robust t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

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