Economic Returns from Social and Political Globalization: Does Signaling Help Developing and Transition Countries to Attract Foreign Direct Investment?

Ekonomický výnos ze společenské a politické globalizace: Může signalizování pomoci rozvojovým a tranzitním zemím přilákat přímé zahraniční investice?

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Abstract

I examine whether a developing or transition country's political and social engagement in the international system – labeled as a country's political and social globalization – has a positive influence on its ability to attract foreign direct investments (FDI), and hence, on the amount of FDI that it receives. My research is motivated by insights from signaling theory, which posits that actors provide information about themselves through signals in situations where the underlying quality or nature of such actors is less than perfectly discernible. A high degree of political and social globalization can potentially serve as a positive signal to foreign investors that a country is "invested" in the international system, global society, and in the larger global political economy, thereby lowering the perceived risk of investing in this country. As part of the empirical analysis, I undertake multivariate regressions using panel data on more than 100 developing and transition countries. The results show that both political and social globalization lower the perceived country risk in terms of attracting FDI. While social globalization helps attract FDI through both strategic and non-strategic signaling, the same is true for political globalization only with strategic signaling and not with non-strategic signaling. Given the importance of FDI to growth and development, the findings of this study can particularly inform policymakers in developing and transition countries.

Keywords

foreign direct investment (FDI), political globalization, social globalization, signaling theory, developing countries, transition countries

JEL Codes

F21, F53, F60

Abstrakt

Příspěvek se zabývá otázkou, zda politická a společenská angažovanost rozvíjející se nebo přechodné země v mezinárodním systému – označovaná jako politická a sociální globalizace země – má pozitivní vliv na její schopnost přilákat přímé zahraniční investice (PZI) a tím i na objem PZI tím, že je přijme. Výzkum je motivován poznatky z teorie

signalizace, která předpokládá, že aktéři poskytují informace o sobě prostřednictvím signálů v situacích, kdy základní kvalita nebo povaha těchto aktérů je méně než dokonale rozpoznatelná. Vysoká míra politické a sociální globalizace může potenciálně sloužit jako pozitivní signál zahraničním investorům, že země je „zainvestována" do mezinárodního systému, do globální společnosti a do širší globální politické ekonomiky, čímž se snižuje vnímané riziko investování do takové země. Jako součást empirické analýzy je provádena mnohořetězcová regrese s využitím panelových údajů o více než 100 rozvíjejících se a transformujících se zemích. Výsledky ukazují, že jak politická, tak sociální globalizace snižují vnímané riziko země, pokud jde o přilákání PZI. Zatímco sociální globalizace pomáhá přilákat PZI strategickou signalizací, totéž platí pro politickou globalizaci pouze se strategickou signalizací, ale ne s nikoli-strategickou signalizací. Vzhledem k významu přímých zahraničních investic do růstu a rozvoje mohou zjištění této studie obzvláště informovat tvůrce politik v rozvojových a přechodových zemích.

Klíčová slova
přímé zahraniční investice (PZI), politická globalizace, sociální globalizace, teorie signalizace, rozvojové země, tranzitní země

I. Introduction

Foreign direct investment (FDI) is commonly understood as a long-term investment by an entity located in a country different from the one where the investment takes place. It is "the purchase of physical assets or a significant share of the ownership (stock) of a company in another country to gain a measure of management control" (Li and Vashchilko 2010)[1]. Compared to other forms of foreign investment, such as foreign portfolio investment in financial instruments, FDI is considered more stable, less volatile, and better at employment-generation (Jensen 2003). Given these properties of FDI, countries around the world have viewed this form of investment as a critical factor in their economic growth and development process. This is particularly so in the case of developing and transition countries (hereafter, developing countries).

In this study, I explore whether a country derives any economic benefits in the form of FDI inflows by politically and socially engaging with the rest of the world. These engagements are labeled as political globalization and social globalization, respectively. Examples of a country's global political engagement comprise membership in international organizations, signing of international treaties, participation in United Nations (UN) peacekeeping missions, and hosting of international non-governmental organizations (NGOs) and foreign embassies. Similarly, examples of a country's social globalization include international migration and tourism, trade in cultural goods and services, and access to the internet and telephones. The argument, as further developed later in the article, is that these two forms of global engagement reduce the perceived risks of investing in a country and such countries should, therefore, attract higher levels of FDI, versus countries that are not high on political and social globalization.

1 *A threshold foreign equity ownership of at least 10% is technically considered for an investment to quality as FDI. However, countries also differ in their threshold values. See United Nations Conference on Trade and Development's definition here: http://www.unctad.ch/Templates/Page.asp?intItemID=3147&lang=1*

It is a widely acknowledged fact that many developing countries compete with each other to attract multinational corporations (MNCs) and the FDI that these firms bring with them (Jensen 2003). The primary motivation for this is the role that FDI plays as an investment vehicle in capital-scarce developing countries. Since income and savings levels are low in many developing countries, FDI represents a key source of revenue and growth for many of these countries. Given this fact, one of the ways in which a developing country can attract FDI is by improving its attractiveness as a potential destination for MNCs.

The standard FDI literature notes various factors in destination countries that help attract FDI, chief among them being a growing economy, size of the market, income levels of consumers, and the investment and regulatory environment.[2] Political scientists and some economists have considered a few domestic political economy variables as influencing the inflow of FDI, notable among them being political risk and corruption, political stability, policy stability, and the nature of the political system. At the international level, research has focused on whether entering into bilateral investment treaties (BITs) and preferential trade agreements (PTAs) and being part of the World Trade Organization (WTO) increases a country's FDI inflows.

While the above-mentioned factors discussed in the literature have proven to be major country-level determinants of FDI inflows, what is missing is a systematic examination of the impact of a country's political and social engagements with the rest of the world on its FDI inflows. With respect to international political engagements, studies focused on BITs and PTAs come close to such an examination since these treaties and agreements represent a country's engagement with the international system (Büthe and Milner 2008; Neumayer and Spess 2005; Sokchea 2007). Another close determinant in this regard is military alliance and its impact on bilateral investment flows (Li and Vashchilko 2010). However, BITs and PTAs still represent international *economic* commitments, even though they are undertaken by states as political entities. As for military alliances, their relevance in correctly signaling the extent of political risk has vastly diminished with the end of the Cold War and the rapidly decreasing incidents of inter-state wars.

Research on the effect of social globalization on FDI inflows comes in the form of studies in international business and strategy that have focused on the cultural aspects of social globalization and used Hofstede's measures of cultural distances (Hofstede 1980). In his widely used and cited work, Hofstede developed four dimensions – power distance, individualism-collectivism, masculinity-femininity, and uncertainty avoidance – to understand and analyze cultural values as observed and exercised at work places in different countries. Later researchers in international business and strategy have used these four measures, and a fifth measure from Hofstede (1991), to examine cultural differences – or, cultural distances – between the origin country of MNCs and the destination country of the foreign investments. Hofstede's measures have since become the bedrock of cross-cultural studies, especially related to international business and strategy. Relevant to the present research are prominent works by Kogut and Singh (1988), Mitra and Golder (2002), Johnson and Tellis (2008), and Tang (2012) that have used Hofstede's measures to

2 *It is beyond the scope of this paper to provide a detailed analysis of the determinants of FDI. Interested readers can refer Blonigen (2005) and Lim (2001).*

examine the influence of cultural distances on the direction and outcomes of firm-level and country-level investment flows.

Even as they are related to the present research, the aforementioned 'cultural distances' studies, however, differ from the present study as they are not focused on the cultural or social globalization profile of destination countries, but rather on the differences between the origin and destination countries. One reason for the conspicuous absence of the large-sample, quantitative type of social globalization studies in the FDI literature is the conceptual difficulty of defining 'social globalization.' The absence of conceptual clarity concerning this term has arguably impeded the development of quantitative measures of this phenomenon. In this paper, I use a novel dataset that provides workable conceptual definitions and quantitative measures of both political and social globalization, thereby making significant contributions relative to the existing literature on FDI. Furthermore, this study makes an important contribution to the existing signaling literature in FDI studies by examining the impacts of intentional signaling (strategic) and unintentional signaling (non-strategic) on attracting FDI. The study also contributes by examining how non-economic forms of globalization – namely, the political and social – impact an economic activity such as FDI. Finally, it advances our overall understanding of developing and transition economies in terms of their relationships to FDI and various forms of globalization.

Given the changed systemic environment in the post-Cold War period, a true international political variable for a developing or transition country would be its political and social relations with other countries, especially with those in the West, and its participation in various international fora. In using the labels of 'political globalization' and 'social globalization' to signify these relations, I am motivated by the more common 'economic globalization' label which reflects the extent to which a country engages economically with the rest of the world. The main question that I examine in this paper is whether there are any economic returns from political and social globalization in the form of increased FDI inflows. I argue that a high degree of political and social globalization can potentially serve as a positive signal to foreign investors that the developing country is "invested" in the international system, both politically and socially. Therefore, these signals lower the perceived risk of investing in this country, *ceteris paribus*, which can theoretically attract more FDI. This would be the case for many developing countries, because these countries first need to transmit positive and credible signals about themselves as political and social units. I further develop this argument in a later section of this paper.

The findings of this study show that both political and social globalization have statistically significant positive relationships with FDI inflows. Countries that politically and socially engage more with the international system of states, international organizations, and global community do attract more FDI. This finding is robust to the inclusion of other variables that have been found to impact FDI inflows. The study also reports that intentional, or strategic, signaling via political globalization has a higher impact on FDI than unintentional, or non-strategic, signaling. This finding differs from that for social globalization where both intentional and unintentional signaling attracts FDI inflows. This finding related to intentional versus unintentional signaling is robust to the inclusion of control variables and to different lag periods for the independent variables but not to the joint inclusion of all the explanatory variables.

The rest of this paper is organized as follows. In section 2, I undertake a brief review of the literature related to the country-level determinants of FDI. I discuss signaling theory, describe the theoretical basis of my argument, and present the conceptual model in section 3. In section 4, I present the research design and the variables, sample, and data. Methodological considerations are also discussed in this section. Section 5 presents the econometric model, reports the results, and undertakes a discussion of the findings. Section 6 provides the conclusions of the study, together with the implications of the findings.

II. Country-Level Determinants of FDI: Discussion of Relevant Literature

In the relevant literature, the determinants of FDI have been studied both from firm-level and country-level perspectives. Firm-level factors and country-level economic determinants have primarily been examined in the international business, economics, and industrial organization literature. On their part, political scientists and international relations scholars working in the area of international political economy have mostly focused on the political factors at the level of the destination country that have influenced FDI inflows. As this study examines FDI at the country-level, I restrict the discussion in this section to the determinants identified in the extant literature.

The country-level elements that influence FDI inflows can be categorized into economic and political factors, with both sets of determinants having been incorporated by the relevant literature in economics, business, political science, and international political economy. Most research has found a positive association of economic factors, such as the levels of gross domestic product, GDP per capita, and economic growth, with FDI inflows (Tsai 1994; Demirhan and Masca 2008). This is to be expected as these economic aspects of a country serve as indicators of the potential market size. Associated with the understanding of market size is the role of population size in impacting FDI inflows (Petrović-Ranđelović, Janković-Milić, and Kostadinović 2017). The economic openness of a country, measured as the share of trade in GDP, is a factor that has been studied and documented in the context of its impacts on FDI inflows. The argument is generally that more open economies receive export-oriented foreign investments while less open economies attract "tariff-jumping" foreign investments that target the destination countries' markets while avoiding the trade restrictions (Demirhan and Masca 2008). Other economic variables that have been used in FDI literature include exchange rate volatility (Ullah, Haider, and Azim 2012) and corporate tax incentives in destination countries (Hunady and Orviska 2014). These variables, especially the latter, have, however, produced mixed results in terms of their association with FDI flows.

There is a large number of political and policy variables that FDI research has included as possible determinants, with a few of them dominating the literature. Political risk is one of the most thoroughly examined political determinants of FDI in both the business and the international political economy literatures. Political risk is commonly understood in this literature to reflect, among other things, the extent of political corruption that foreign

firms face, with political risk being higher in countries characterized by greater levels of corruption (Busse and Hefekar 2007). The principal political risk that foreign firms face in the investing country is of expropriation, that is, the sudden nationalization of the business by the national government (Henisz 2000). Such risks have been waning in recent decades because of the increasingly vertical nature of FDI entering developing countries.[3] However, there is still evidence that outright expropriation occurs in some parts of the developing world.[4]

Besides political risk, scholars have primarily focused on the relationship between a democratic political system and FDI inflows. Traditional literature contended that MNCs would be more attracted to countries governed by autocratic regimes given the control that such governments have over political institutions and FDI policy (O'Donnell 1978). In other words, autocratic governments would be immune to public opinion since they do not seek re-election. This presents greater certainty regarding FDI policy, a feature greatly valued by MNCs. However, more recent studies have found a positive association between levels of democracy and FDI inflows (Rodrik 1996; Harms and Ursprung 2002; Jensen 2003; Busse 2004). Other political variables in potential destination countries that have been featured in FDI studies include policy stability and the role of veto players (Tsebelis 2002; Jensen 2003; Li 2009) and the importance of bilateral investment treaties (BITs), preferential trade agreements (PTAs), and membership in international organizations, such as the WTO (Büthe and Milner 2008). The number of variables identified and evidenced in the FDI literature as possible determinants is indeed large and growing. While this is reflective of an active research agenda concerning FDI, it also presents a challenge to researchers in terms of potential variables to consider for further research on this topic. As will be explained in section 5, the present study has adopted a parsimonious empirical model that adequately captures the effects of the key economic and political determinants of FDI.

III. Signaling Theory: Globalization and FDI

The present study recognizes the wealth of research undertaken on this topic but argues that the relevant literature is missing an examination and analysis of how FDI inflows are influenced by both intentional and unintentional signaling by a developing country as it engages in the processes of political and social globalization. Definitions and explanations abound for the term 'globalization,' but for the purposes of this study, it can be understood as "the process of increasing interconnectedness between societies such that events in one part of the world more and more have effects on people and societies far away" (Baylis and Smith 1999: 7). The idea is that globalization represents a trend that has led

3 *Under vertical FDI, a firm does not locate its entire line of production and business in a foreign country, and hence, the FDI does not represent a stand-alone business unit. As such, vertical FDI is less vulnerable to expropriation risk since the expropriating government would be left with a worthless asset (Büthe and Milner 2008).*

4 *For example, in both Bolivia and Venezuela, left-leaning governments have nationalized foreign-owned businesses in the past decade (The Economist 2010a, b).*

the world to a state of interdependence (Keohane 2002). Furthermore, globalization is understood differently here from internationalization, liberalization, universalization, and Westernization, although these terms maybe closely related and are sometimes used interchangeably (Scholte 2008; Caselli 2012; Gygli, Haelg, and Sturm 2018). Conceptually, "social globalization expresses the spread of ideas, information, images and people" while "political globalization characterizes the diffusion of government policies" (Gygli, Haelg, and Sturm 2018: 3). With social globalization, one finds greater cultural, interpersonal, and informational engagements between citizens and residents of different countries. A country is assumed to be more socially globalized if it permits and engages in the aforementioned interactions between its citizens and the rest of the world. Political globalization, on the other hand, is characterized by a country's formal involvement in international organizations, international treaties, UN missions, and international investment treaties. This concept captures the extent to which a country's government legally and practically involves itself with the affairs of the global political world. These two forms of globalization are, therefore, distinct from the more commonly known form of globalization – economic globalization – that is reflected in the exchange and flows of goods, capital, and services among countries.

In drawing a connection between the two distinct dimensions of globalization – political and social – and FDI inflows, the present study is motivated by insights from signaling theory, which posits that actors provide information about themselves through signals in situations where the underlying quality or nature of such actors is less than perfectly discernible and when such actors seek to provide information about themselves. An early work that contained the idea of signaling was Thorstein Veblen's (1899) celebrated piece on the "leisure class" (Bagwell and Bernheim 1996). Veblen argued that wealthy individuals often engaged in conspicuous and wasteful expenditure to signal their wealth, thus elevating themselves to a higher social status. The underlying idea is that it is not just enough to be wealthy; one has to flaunt it through *costly* expenditure to signal the extent of one's wealth to one's peers and competitors. This idea forms the basis of the theoretical and empirical literature related to costly signaling, where the cost of signaling is so high that the signals are treated by recipients as credible.[5] For the present study, this costly signal is transmitted by developing countries when they engage with the international community, both socially and politically. And this signal is costly for developing and transition countries because, relative to developed economies, many of these countries face challenges in terms of resources and capacity. International engagement in this context is, therefore, a costly signal.

The need for signaling arises when asymmetric information prevails, that is, when all the relevant actors do not have the same amount of information. This is typically observed in market interactions where sellers know more about the quality of the products or services they offer for sale than the buyers do (Boulding and Kirmani 1993). With respect to FDI, the relevant actors are the MNCs and the potential destination countries, with MNCs typically possessing less information about potential destination countries compared to

5 *An everyday occurrence of costly signaling from the job market is when job applicants signal their worth to prospective employers through their educational qualifications, which were costly and time-consuming to acquire for the applicants (Spence 1973).*

what these countries know about themselves and their own country-level characteristics. One manner in which these countries can transmit positive information about themselves is through a process of stable and credible engagement with the rest of the countries in the international system. Such engagements, on both social and political fronts, can potentially serve as a positive signal to foreign investors that the country is 'politically invested' in the international system and 'socially integrated' with the rest of the world. These positive signals, in turn, lower the 'perception' of the underlying risk of investing in this country. In other words, it lowers perceptions of the destination's 'country risk,' which also includes political risk as a major component. Given the negative relationship that exists between country risk and foreign investments, it is argued that higher levels of political and social globalization that mitigate the perceptions of country risk have the potential to attract more FDI.

There is support for this theoretical argument in mainstream international relations literature that has led us to understand international relations, including international economic relations, as characterized by strategic interactions that are based on incomplete information (Lake and Powell 1999; Keohane 1984). Given this scenario, costly signaling becomes a credible mechanism to provide positive information in an environment of incomplete information and uncertainty. For example, in the context of global peace and inter-state relations, signaling is important for countries to convey peaceful intentions and to inform the credibility of their commitment to collaborative effects (Kertzer, Rathbun, and Rathbun 2018). In the case of foreign investments, political and social globalization lowers the perceived political risk of a country by making it costly for it to violate internationally accepted norms and standards of conduct, including as they relate to foreign investment inflows.

The theoretical argument in this study is that political and social globalization can impact FDI through the signaling process by sending out two kinds of signals: intended and unintended. In the case of intentional signals, countries strategically 'market' themselves as credible, invested, and integrated in the international system and society of states. The idea that there exists an 'international society' where countries form social bonds based on a societal understanding of inter-state relations was long and influentially established by the English School of international relations (Kaczmarska 2017). Hedley Bull most famously stated that an international society "exists when a group of states, conscious of certain common interests and common values, form a society in the sense that they conceive themselves to be bound by a common set of rules in their relations with one another, and share in the working of common institutions" (Bull 2002: 13). Following this understanding, it is assumed that a developing country that engages in various forms of political and social globalization transmits positive signals about the credibility of its engagement with the international community and of its commitment to adhere to international norms.

Developing and transition countries also send unintended positive signals about themselves when they join international organizations, host embassies of other countries, and engage in U.N. missions. That is, countries transmit positive information about themselves in an unintended manner when they interact with international organizations and other states in the international system. These actions might have been undertaken

not with the expectation or intention that they will exert a positive impact on the extent of FDI, although that is also a possibility that this study incorporates in its analysis. The theoretical framework, therefore, provides for two possible channels through which the signaling process works to enable the more politically and socially globalized developing countries to receive more FDI – the intentional and the unintentional.

Figure 1: Conceptual Model of the Impact of Political and Social Globalization on Foreign Direct Investment (FDI) Inflows

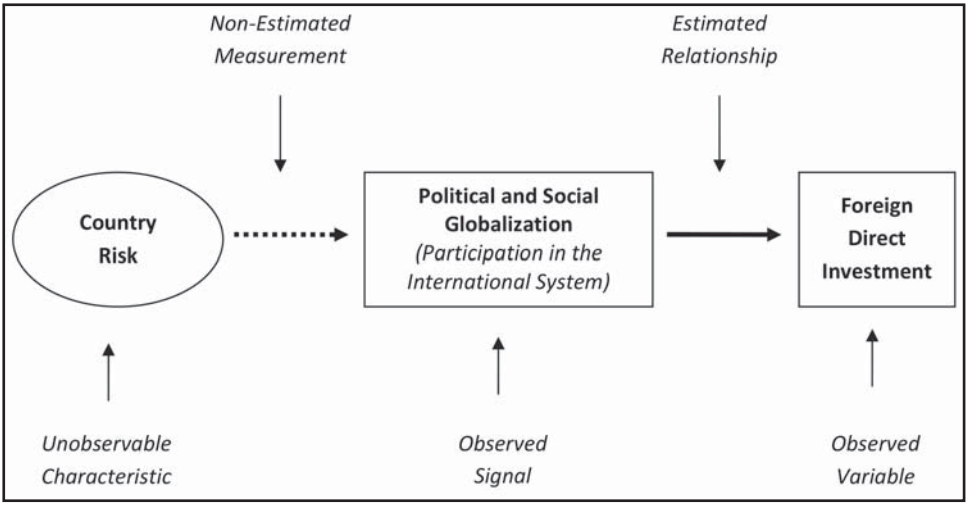

Figure 1 presents the conceptual model that demonstrates the nature of the hypothesized relationships. Country risk constitutes the *unobserved* country characteristic that is of interest to MNCs while taking their foreign investment decisions. However, by their participation in the international system – denoted here as *political globalization* and *social globalization* – developing countries transmit signals that can be *observed* by foreign investors. The degree of *political globalization* and *social globalization* are then hypothesized as having positive impacts on the amount of FDI that such countries receive. For obvious reasons, the extent to which these types of globalizations serve as signals of the level of country risk inherent in a country is a non-estimated measurement. The estimated measurement is the relationship between these two types of globalization and FDI inflows.

IV. Research Design

This study comprises three main variables of interest: *FDI, political globalization*, and *social globalization*. On the basis of prior literature, I also incorporate numerous control variables to account for their influences on FDI. I first explain the variables, together with their operationalization and data sources, and then present the sample. In this section, I also discuss the methodological considerations that underpinned the choice of the regression models.

Outcome Variable – Foreign Direct Investment: In defining *FDI*, I use a commonly-accepted definition that it is "an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)" (UNCTAD 2003: 231). The overarching idea is that FDI represents an investment in which the foreign entity holds a non-trivial financial interest and exerts considerable influence on its management and investment outcomes. For this study, I use net inflows of FDI that account for any disinvestments by foreign investors in a country.[6] The data is sourced from the World Development Indicators database of the World Bank. For the analysis, *FDI* is measured as the net inflows of FDI as a percentage of GDP, thereby, both normalizing FDI inflows across countries and accounting for the near-universal finding of GDP being a strong determinant of FDI (Büthe and Milner 2008).

Explanatory Variable – Political Globalization: Political globalization constitutes one of the two explanatory variables in this study and represents the extent to which a country engages politically with the international system. Put differently, political globalization captures the "inter-national relations" of a country in terms of the following (Dreher 2006: 1093): "the number of embassies in a country, the number of international organizations to which the country is a member and the number of UN peace missions a country participated in…" The data for *political globalization* was sourced from the 2018 KOF Index of Globalization that measures political globalization exactly as defined above and on an increasing scale from 1 to 100 (Dreher, Gaston, and Martens 2008).[7]

Explanatory Variable – Social Globalization: *Social globalization* is the second explanatory variable of interest in this study and is also sourced from the 2018 KOF Index of Globalization. As previously explained, it is understood as the cultural, interpersonal, and informational exchanges between countries. The KOF Index of Social Globalization measures *social globalization* exactly by this definition and, as is the case with *political globalization*, measures it on an increasing scale from 1 to 100 (Dreher, Gaston, and Martens 2008).

Control Variables: A wide range of determinants have been identified in the FDI literature and incorporating all of them would present both sample-size and methodological issues. I, therefore, draw on prior literature to include three of the more prominently identified factors as the control variables, two of which are economic and the third captures the political effects: *market size, economic growth*, and *political regime*. Market size positively impacts FDI inflows and is measured by the natural logs of both GDP per capita and population size. Both the GDP and GDP per capita data is in constant 2010 US dollars. The rate of economic growth is measured as annual percentage changes in GDP. In light of the numerous political variables used in prior FDI research and the competing need to choose parsimonious models, I include one possible political determinant – *political*

6 *Note that "net inflows" of FDI does not refer to FDI inflows less the FDI outflows undertaken by entities located in the recipient countries.*

7 *The percentage weights for both the Political Globalization Index and the Social Globalization Index are provided in the appendix. Note that each of these aggregate indices are averages of the respective de facto and de jure indices that KOF Index of Globalization has constructed for these globalization indices.*

regime – that captures most of the political features that the analysis seeks to include in the models and that has been found to be a significant determinant in past FDI studies. Political regime types vary from autocratic to democratic and this continuum is captured on a 21– point scale from – 10 (fully autocratic) to +10 (fully democratic), that is, on an increasing scale of democracy.

The data for *GDP*, *GDP per capita, population*, and *economic growth* were sourced from the World Development Indicators database of the World Bank. *Political regime* data is from the POLITY 2 time-series variable from the POLITY IV database.[8] The data for each variable are annual observations that run from 1970 to 2015 for each country. However, for some variables, data is missing both across a few countries and for some of the years. Hence, the panel data in this study is unbalanced. The initial sample consists of 150 developing and transition countries that were not members of the economically advanced countries that comprise the Organization for Economic Cooperation and Development (OECD) as of the start of the data period, that is, 1970. However, due to missing data the effective sample is 125 countries. The exclusive focus of this study on developing and transition countries is consistent with the theoretical arguments advanced here: as discussed earlier, signaling their investment credibility through political and social globalization is costlier for developing and transition countries due to the resource and capacity constraints that they face relative to economically advanced countries.

Panel data analysis incorporates both the longitudinal and the cross-sectional variation into the estimation process. This helps capture the temporal (over many years) and spatial (across countries) dimensions of the data, and thus provides for a richer analysis. However, the richness that panel data analysis provides calls for the careful choice of regression models. For panel data analysis, the main methodological problem is that of choosing between a fixed effects model and a random effects model. This is because these two models differ in their handling of omitted variables across the units and over time. While fixed effects models are generally preferred in panel data analysis because they provide consistent results, they are not necessarily the most efficient models. Random effects models are more efficient, provided it is statistically reasonable to use them.

The classic test that has been used to choose between a fixed effects model and a random effects model is the Hausman test. This test compares the estimated results from a fixed effects model with that of a random effects model to verify if the two test results are significantly different from each other in a statistical sense. If they are significantly different, then a fixed effects model must be used. For the present study, a Hausman test was undertaken and the results between running a fixed effects model and a random effects model were found to be significantly different from each other. Therefore, the fixed effects model was chosen to conduct the analyses, the results of which are reported and discussed in the next section. I employed an econometric technique that was appropriate for use with unbalanced panel data, as is presently the case. I ran fixed effects models with an adjusted Driscoll-Kraay estimator and standard errors that are robust to heteroskedasticity, autocorrelation, and cross-sectional (spatial) and temporal dependence (Hoechle 2007).

8 http://www.systemicpeace.org/inscr/inscr.htm

V. Empirical Analysis: Model Specification, Results, and Discussion

The full model using both *political globalization and social globalization* and the control variables is specified below. However, I also ran various models based on the same general specification. In the analysis, the dependent variable is converted into percentages. Following Büthe and Milner (2008), the right-hand side variables are lagged by one year, since the independent variables do not impact FDI inflows contemporaneously. However, as part of robustness checks, I run models with different lag years. In all the models, the expectation is of positive signs for all the coefficients.

$$\left(\frac{FDI_{i,t}}{GDP_{i,t}}\right) = \beta_0 + \beta_1 PolGlob_{i,t-1} + \beta_2 SocGlob_{i,t-1} +$$

$$+ (\gamma_1 Z_{1,i,t-1} + \ldots + \gamma_k Z_{k,i,t-1}) + u_{i,t-1}$$

where, i=1…150 (countries in the sample)
t=1970…2015 (data period)
$Z_{k,i,t-1}$= control variables
β_1,β_2= coefficients for the explanatory variables
γ_κ= coefficients for the control variables

I undertook a series of tests using different model specifications. The results are reported in table 1. Model 1 is the controls-only model that uses variables identified in existing literature as determinants of FDI inflows. Models 2 and 3 include only *political globalization* and *social globalization*, respectively, apart from the control variables. Model 4 is the full model with both *political globalization* and *social globalization* and all the control variables. Model 1 results show that all the coefficients are statistically significant and take the expected positive signs. These results are in line with the findings from existing FDI literature.

The results from models 2 and 3 show that both *political globalization* and *social globalization* are positive and statistically significant. We find that the same result holds for the full model no. 4, where both *political globalization* and *social globalization* are included in the same model and both these variables of interest are statistically significant with the hypothesized signs. Between the two variables, we do find that *social globalization* has a greater impact on FDI inflows and a higher level of statistical significance. Of the control variables in these three models, *economic growth* and *population* are consistently significant and take the expected positive sign. *GDP per capita and political regime* are positive and significant only in model 1. The overall results provide strong empirical support for the research hypothesis that countries with higher degrees of political and social globalization attract more FDI. The theoretical argument that underpinned this expectation was that countries that politically and socially engaged more with the international system signaled a greater commitment to the principles of international engagement, which in turn lowered their perceived risk levels.

Table 1: Fixed Effects Models of Signaling and FDI Inflows

Variable	1	2	3	4
Political Globalization		.05*** (.01)		.02* (.01)
Social Globalization			.13*** (.02)	.12*** (.02)
Market Size				
GDP per Capita	1.65*** (.46)	1.01* (.56)	.006 (.62)	-0.08 (.65)
Population	4.15*** (.72)	2.76*** (.70)	2.13*** (.61)	1.78*** (.63)
Economic Growth	.09*** (.01)	.08*** (.01)	.08*** (.01)	.08*** (.01)
Political Regime	.05** (.02)	.03* (.01)	.006 (.01)	.005 (.01)
Countries	125	125	125	125
Observations	4316	4272	4272	4272
F-stat	12.43***	16.22***	35.76***	37.78***
R-squared	.09	.09	.10	.10

*Note: *p< 0.1, **p< 0.05, ***p< 0.01; Driscoll-Kraay standard errors in parentheses; all independent variables are lagged by one year*

As an example, China is a posterchild for how it signaled foreign investors through greater engagement with the global community – both politically and socially – since 1979, after having remained self-isolated during the period 1949–79 (Hayter and Han 1998). By the late 1980's, China had established diplomatic relations with 133 nations, the most since its founding as the People's Republic of China in 1949 ("Foreign Relations"). By the year 2000, China had cumulatively received $347 billion in FDI and was averaging over $40 billion annually, which represented almost 20 percent of the FDI flows to developing countries (Broadman 2002).

In Eastern Europe, Lithuania in the 1990s serves as an illustrative example of international engagement resulting in inward foreign investment flows. Greater engagement with the International Monetary Fund and the World Bank during its post-communist years in the early 1990s not only helped Lithuania secure million-dollar loans from these institutions but it also attracted multi-million dollar private foreign investments in Lithuanian factories and plants (Kimbell 1994). Lithuania's turn around in this context is particularly illustrative since, according to the OECD, "one reason for the initially slow development of FDI in Lithuania was the generally low profile of the country internationally" (OECD 2000: 30).

Descriptive examples of China, Lithuania, and other countries politically and socially globalizing themselves and attracting FDI flows abound in the recent global political economy. However, of further interest to this research is whether the positive influence of *political globalization* and *social globalization* on FDI inflows work through the intentional

signaling channel or the unintentional one, or both. This examination is important to distinguish between the effects of strategic signaling (intentional) versus non-strategic signaling (unintentional) so developing and transition countries can prioritize their political and social globalization maneuvers. For this stage of the analysis, we exploit the bifurcation of the KOF indices of political and social globalization into *de facto* and *de jure* globalizations to account for different dimensions and characteristics of globalization (Gygli, Haelg, and Sturm 2018). "While *de facto* measures of globalization include variables that represent flows and activities, *de jure* measures include variables that represent policies that, in principle, enable flows and activities" (Gygli, Haelg, and Sturm 2018: 2). In other words, by virtue of being policies strategically undertaken by governments, *de jure* globalization approximates to intentional signaling, according to our theoretical framework. By the same argument, *de facto* globalization represents unintentional signaling as these signals are not strategically produced but released unintentionally in the normal course of a country's engagement with the global community.

Table 2: Fixed Effects Models of FDI Inflows – Intentional and Unintentional Signaling

Variable	Intentional Signaling		Unintentional Signaling	Full Model	
	5	6	7	8	9
Political Globalization (De Jure)	.05*** (.01)				.03*** (.01)
Social Globalization (De Jure)		.12*** (.02)			.09*** (.02)
Political Globalization (De Facto)			.009 (.01)		-0.009 (.009)
Social Globalization (De Facto)				.07*** (.02)	-0.002 (.02)
Market Size					
GDP per Capita	.82 (.59)	-0.05 (.64)	1.59*** (.48)	0.94 (.56)	-0.12 (.68)
Population	2.26*** (.78)	1.69*** (.50)	4.08*** (.66)	3.39*** (.76)	.99* (.56)
Economic Growth	.08*** (.01)	.08*** (.01)	.09*** (.01)	.08*** (.01)	.08*** (.01)
Political Regime	.03 (.01)	-0.006* (.01)	.04** (.01)	.03* (.02)	-0.003 (.01)
Countries	125	125	125	124	124
Observations	4272	4272	4272	4221	4221
F-stat	25.05***	29.47***	10.71***	31.45***	34.46***
R-squared	.09	.10	.09	.09	.10

*Note: *p< 0.1, **p< 0.05, ***p< 0.01; Driscoll-Kraay standard errors in parentheses; all independent variables are lagged by one year*

Table 2 contains results of the analyses conducted to examine the separate effects of intentional and unintentional signaling on FDI inflows. Both *political globalization* and *social globalization* are deconstructed into *de jure* and *de facto* indices by the KOF Index of Globalization. Models 5 and 6 report *de jure* results while *de facto* results are presented in models 7 and 8. Each of these four reduced models contains only one of the four *de facto* or *de jure* variable, apart from the control variables. Model 9 is the full model with all the variables. Taken together, the results from models 5 and 6 demonstrate that both *de jure* political and social globalization are statistically significant and take the expected positive sign. The results from model 7 show that *de facto* political globalization has a positive coefficient but is not significant in a statistical sense while model 8 results indicate that *de facto* social globalization is both positive and statistically significant. In the full model, only the *de jure* sub-variables for both political and social globalization are statistically significant with the expected positive signs.

We can interpret these results as evidence that only *de jure* political globalization has an impact on FDI glows, with *de facto* globalization not displaying any statistically significant effects. However, social globalization appears to influence FDI inflows through both the *de jure* and *de facto* channels. In terms of intentional versus unintentional signaling, we can, therefore, conclude that the impact of *political globalization* on FDI inflows works only through the intentional route. For *social globalization*, this effect on FDI is observed through both the intentional and unintentional channels, although the unintentional mode of impact is not robust to the inclusion of additional variables.

As part of robustness checks, I ran the same reduced and full models for both sets of analyses with lags of two, three, and five years for the right-hand side variables. All the results, which are unreported, were robust to the change in lags. Moreover, for the reduced model with the three-year lag, *de facto* political globalization was found to be positive and statistically significant.

To account for experiential differences of a historical nature between developing and transition countries, a final set of analyses was performed on separate sub-samples of developing countries and transition countries. All formerly-communist central and eastern European countries formed part of the transition group of 24 countries while the rest of the 101 countries were grouped as developing countries. The analyses were conducted for models with one, two, three, and five year lags of the independent variables. The results, which are unreported, largely show that *political globalization* and *social globalization* are statistically significant variables for both groups of countries to attract FDI, although for transition countries the impact of *political globalization* occurs with a lag of at least three years. Moreover, for full models, only *social globalization* returned any statistical significance across the four different time-lags for both groups. The results for intentional and unintentional signaling mirrored the results from the main analysis – the reduced models indicate statistically significant effects of *de jure* political and social globalization and *de facto* social globalization but not of *de facto* political globalization. For the full models, the *de jure* variables – or intentional signaling – for the developing country group for both political and social globalization were the only factors that sustained their statistical significant across the four different year-lags. For transition countries, this consistency was absent, possibly due to low data points. The overall understanding from

this final set of differentiated analyses is that political globalization of the intentional type and social globalization of both the intentional and unintentional varieties are significant determinants, in a statistical sense, of FDI inflows into developing countries as well as transition countries.

VI. Conclusions

This study allows us to draw various conclusions concerning the relationship between political and social globalization and FDI inflows. First and foremost, these two non-economic forms of globalization matter for FDI in developing and transition countries as they lower the country risk perceptions, which past research had documented as having a negative effect on FDI inflows. Second, in the case of political globalization, strategic signaling has better prospects of attracting FDI than nonstrategic signaling. Foreign investors are more impressed by a country's policy moves, such as participation in international organizations and investment treaties, than in its mundane activities of hosting foreign embassies and international NGOs. Third, for the most part, social globalization exerts positive influence on FDI inflows through both the strategic and non-strategic channels. However, for this variable too, foreign investors are more positively influenced by public policies and social systems that promote social development, encourage international engagement, and ensure social freedoms than by the presence of international agents and activities. Finally, though there exist historical differences between developing countries and transition countries, both political and social globalization influence FDI inflows to these two groups of countries, although in the case of the transition countries the influence of political globalization appears to take place with a longer lag.

An immediate implication of the findings of this study is that developing and transition countries that need to signal their investment-worthiness can economically benefit from their political and social engagement with the outside world. The further implication is that there are economic returns to political and social globalization through both strategic and non-strategic signaling. This is a novel understanding since, in discussions on globalization, economic returns are generally associated with economic globalization and not political or social globalization.

In advocating for greater political and social engagement with the global community as a means to attract FDI, this study does not imply that all FDI is beneficial to the recipient countries. There are serious and valid arguments raised by scholars concerning the possible negative impacts of FDI. But exploring them are outside the scope and direct interest of this study, although it is imperative to note that developing and transition countries be cognizant of the quality of the incoming investments. The findings and conclusions of this particular study indicate the fact that international economics is so intricately intertwined with the political and social dimensions of the global community that they have to be studied in unison to obtain a deeper and clearer understanding of the workings of the global political economy.

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APPENDIX: KOF Index of Globalization 2018: Structure, Variables, and Weights

Social Globalization, de facto	**Weight (%)**	**Social Globalization, de jure**	**Weight (%)**
Interpersonal Globalization, de facto	*33.3*	*Interpersonal Globalization, de jure*	*33.3*
International voice traffic	22.9	Telephone subscriptions	38.2
Transfers	27.6	Freedom to visit	31.2
International tourism	28.1	International airports	30.6
Migration	21.4		
Informational Globalization, de facto	*33.3*	*Informational Globalization, de jure*	*33.3*
Patent applications	35.1	Television	25.2
International students	31.2	Internet user	31.9
High technology exports	33.7	Press freedom	13.2
		Internet bandwidth	29.7
Cultural Globalization, de facto	*33.3*	*Cultural Globalization, de jure*	*33.3*
Trade in cultural goods	22.6	Gender parity	31.1
Trademark applications	13.3	Expenditure on education	30.9
Trade in personal services	25.6	Civil freedom	38.0
McDonald's restaurant	23.2		
IKEA stores	15.3		
Political Globalization, de facto	**Weight (%)**	**Political Globalization, de jure**	**Weight (%)**
Embassies	35.7	International organizations	37.0
UN peace keeping missions	27.3	International treaties	33.0
International NGOs	37.0	Number of partners in investment treaties	30.0