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Barriers to FDI: Analyzing the role of geopolitical factors in the host country's decision to block foreign acquisitions

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Abstract

Globalization has caused a massive increase in foreign direct investment (FDI) in the past decades. There has been extensive literature on the positive effects that inward FDI brings to the host country. These include wage effects and overall economic growth, for example. Therefore, the literature creates a narrative that emphasizes the positive perception that host countries have, and should have, towards inward FDI. Little to no attention, however, has been given to potential negative perceptions countries might have regarding this matter. US federal data used in this paper shows that numerous foreign inward acquisitions are being blocked every year by the American government. This proves that FDI is not always regarded as a good thing. Moreover, this raises the question what moves authorities to actively keep foreign investments out of their country. The goal of this paper is to investigate whether military factors might play a role in this. If the military capability of a source country influences the likelihood of the blockage of outward FDI from their businesses, this might suggest that military aspects matter in international business, even when physical warfare is not apparent. In addition, country-level military and political factors will be introduced as moderators to further see if economic forces are tied to geopolitical tactics. The results of this paper show that the military capability of a source country is positively related to the amount of blocked acquisitions from said country in the US. In addition, it is found that military alliances and political relations weaken this relationship. This is a contribution to the current literature, seeing as there has not been any empirical research before regarding the blockage of FDI.

Key words: FDI, Acquisitions, CFIUS

JEL classification: F21, F23, M38

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1. Introduction

Even though big western economies nowadays mainly try to refrain from physical warfare, this does not mean that there are no tensions between one another. A striking example of this is the reaction from big western economies to the war between Russia and Ukraine. A physical war is being prevented at all costs due to, among other things, nuclear threats. Thus, countries find other, less violent, ways to thwart each other. In the case of the war between Russia and Ukraine, financial institutions are being cut off by big western economies and trade with Russia is being hampered. This is a straightforward, more or less aggressive, way of what some might call 'economic warfare' (Clemens, 2013). There are, however, more subtle ways countries can take economic measures against rival economies. These measures do not necessarily have to be offensive, but can be defensively natured as well. One way a nation can protect itself from 'rivals' is through the blockage of FDI coming from businesses in their country. This is done through government-controlled review mechanisms. When authorities think that a certain foreign inward investment could pose a threat to national security, a review procedure against this investment can be initiated. This might ultimately result in the investment being blocked. Potential reasons for this can be that the host country administration does not want businesses from a certain country to get access to critical technologies or other important national information. Previous scholarly attention has mostly been focused on the positive stance countries have towards FDI. The literature creates a narrative that host countries are always well-willing to welcome foreign investments. Therefore, there seems to be this notion that host countries are doing everything they can to actively lure in FDI. Little to no attention, however, has been given to the other side of the spectrum. The dataset used in this thesis shows that, through the mechanics of the aforementioned review mechanisms, a certain share of inward FDI is proactively being blocked by host countries every year. This raises the question what exactly triggers the blockage of foreign investments, especially considering the positive scholarly attitude towards FDI. In other words, what makes it that certain investments are being reviewed and therefore potentially blocked, and others are not? This is something that has not been empirically researched before. In this paper, the relation between the military capability of a source country and the possible blockage of investments in the US will be researched. It can be argued that a more military capable country is a bigger potential threat to the national security of the host country. As a consequence of that, host countries might be more likely to block acquisitions of these source countries. Moreover, I will investigate whether this potential

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effect is moderated by certain country-level features. First, the moderating effect of the number of military alliances the source country has with the host country will be researched. If there indeed is an effect, then this further entails that the amount of reviewed, and therefore potentially blocked, acquisitions are dependent on military factors. Furthermore, the potential moderating effect of political relations and state legitimacy on the main relation will be investigated. This would mean that other geopolitical factors play a role in the blockage of acquisitions as well. To investigate this, the following research question will be examined in this thesis:

RQ: To what extent is the blockage of acquisitions by a host country related to the military capability of a source country, taking geopolitical factors into account?

I will first dive deeper into the previous material on host country effects of inward FDI, suggesting that these effects are generally perceived as positive by the existing literature. I will even further outline the positive stance host countries have towards FDI by explaining techniques they use to actively attract foreign investments. I will then look at potential reasons for negative perceptions of FDI, which helps build my theory, followed by hypotheses regarding this matter. These negative perceptions presumably are related to the emergence of 'FDI protectionism', which will be discussed in more detail later. By using data of the government committee responsible for the US review mechanism, the CFIUS, I will try to empirically test my hypotheses to see if my theory is supported. I will then provide a discussion and end with a conclusion. This research is a start in recognizing the triggers of blocked foreign investments. Furthermore, an effort is made in relativizing the overwhelming positive scholarly attitude that exists towards the host country perception of FDI. This thesis tries to show that source country-level factors can have a negative effect with regards to FDI in a host country. This is a topic that has not been empirically researched before.

2. Literature review and theoretical framework

2.1 Positive host-country perception of foreign influences

There has been an extensive coverage of FDI in international business literature. A lot of scholars have argued that FDI brings positive effects to the host country. There can be all sorts of different antecedents for these positive effects. Moreover, these positive effects can have consequences for different local actors. Lipsey (2004), for example, highlights four different categories of positive host country effects with regards to FDI: wages, productivity, new industry introduction, and economic growth. These effects will be discussed below.

There can be different reasons for a positive wage effect within the host country following foreign investment. Some scholars have found evidence that foreign-owned firms pay higher wages on average compared to national firms (Blomström & Persson, 1983; Harrison, 1996). In addition, others suggest that “wage spill-overs” might take place (Aitken, Harrison & Lipsey, 1996). They indicate that the presence of a foreign multinational might drive up the wage levels of domestic firms.

The overall productivity of an industry in the host country might also be positively affected when foreign investment takes place. For example, evidence suggests that the productivity in foreign multinational firms is substantially higher than productivity in domestic firms (Blomström and Wolf, 1994). In addition, Blomström et al. (1999) argued that new information brought by transnational corporations can lead to positive “spill-over” effects. In general, it is suggested that these spill-over effects often arise as a result of diffusion of new technologies and management practices introduced by the foreign multinational (Fu, 2012). Local firms in the host country can benefit from these effects through demonstration effects, labor migration or buyer/supplier linkages. In turn, this drives up the local productivity in these sectors. Others have found similar results (Caves, 1996; Liu et al. 2000). Another positive effect of FDI regarding host country productivity is related to specialization. Rivera-Batiz and Rivera-Batiz (1991) highlighted that an effect of inward FDI can be an increase in specialization in services in the host country. This has a positive effect on the local related industries, since this benefits the efficiency.

Positive effects of FDI may also arise because of new industry introduction. Dobson and Chia (1997) describe how firms in their study find a way to integrate certain foreign countries into their production network. These firms supply the investments necessary for companies in the host country to set up production facilities, completing their production network and creating

a new industry in the host country. FDI could also lead to domestic market innovation. Lall (2020) claims that the local competition in a host country is stimulated when investments are being made by a multinational company. Moreover, the allocation of resources can be improved, leading to innovations in the local market. In turn, these effects can be seen as positive consequences of FDI.

While the aforementioned effects usually tend to be industry-specific, FDI can also lead to economic growth in the host country, which could benefit the nation as a whole. De Mello (1999), for example, found that an increase in foreign investments led to economic growth in both developing and developed host countries. Other scholars have found similar results. For instance, Campos and Kinoshita (2002) came to the conclusion that an increase in FDI is positively related to economic growth in the host country.

2.2 Efforts to attract FDI

In general, this literature suggests that it can be argued that FDI should be applauded by the host country. This is why governments all around the globe are actively trying to lure multinationals to their country in order to invest there (Hanson, 2001). A common way of attracting FDI to the host country is by providing foreign firms with fiscal incentives. Tax holidays, for example, are temporary periods of time in which a firm is offered a tax reduction by the local government (Bond & Samuelson, 1986). Other fiscal incentives include investment allowances, income tax reductions and import duty exemptions (Brewer & Young, 1997). Van Parys and James (2010) found that an increased number of legal guarantees along with a reduced complexity of the tax system has a positive effect on the amount of FDI a host country attracts. Local authorities can also provide foreign investors with financial incentives. For example, host country authorities may attract foreign investors by providing them with subsidies (Chor, 2009). Other financial incentives include subsidies, government credit, insurance at a preferential rate and equity participation (Brewer & Young, 1997).

Furthermore, there are alternate incentives a host country can provide. For example, foreign firms can be given protection from import competitions and favorable foreign exchange rates (Cleeve, 2008). Rajan (2004) finds that policy interventions are the most effective ways countries can lure in foreign investments. In this regard, Azémar and Desbordes (2010) point out that an effective alternative instrument to attract foreign investments can be the change of certain economy-wide policies. For example, they argue that the easing of firing rules within

the country can lure in foreign companies. Some countries even go as far as directly advertising their nation. Morisett (2003) describes how nations make use of International Promotion Agencies (IPAs) to market themselves to foreign enterprises. Morisett and Andrew-Johnson (2004) found that some countries use up to 38% of their budget on these IPAs. This might be part of a strategy that Teslik (2007) describes as 'national branding'. Countries are promoting their brand in order to appear more attractive as a business environment for foreign businesses. An example of this is exploiting positive preconceptions people might have about the country.

Through fiscal, financial and other incentives governments are trying to reap the aforementioned benefits of foreign investments in their country. Moreover, this shows the great extent to which host countries place value on FDI. They do not only perceive the effects of FDI as positive, in fact, host countries use incentives to actively try to lure in foreign investors.

2.3 Negative host-country perception of foreign influences

Sometimes governments do not react so positively to foreign influences in the local economy. For example, measures can be taken to discourage foreign companies to establish presence in a country. With regards to foreign trade, Pape (1997) distinguishes two main categories of economic sanctions a country can take: trade restrictions and financial restrictions. Tariffs may be raised to complicate trade for foreign companies and financial flows can be wholly or partially blocked. With regards to negative reactions of countries to FDI, little literature exists. Sauvart (2009) pointed out that there has been a rise in FDI protectionism. In particular, he looked at how several authorities have put review mechanisms into place, in order to look at incoming foreign investments more strictly and potentially block them. This tells us that there are reasons for governments to not necessarily perceive foreign investment as a positive thing. In fact, this even tells us that authorities are actively blocking incoming investments. This is interesting, since there has been extensive literature on the positive effects of FDI in a host country, as we have seen before. The question therefore is what exactly moves authorities to regulate incoming foreign investments and even block them. Little research has been devoted to negative perceptions of FDI in the host country. On top of that, no empirical analysis has ever been conducted with regards to the active blocking of FDI by host countries. It is this research gap that will be at the base of this thesis. It is argued that these review mechanisms are often put into place to foster 'national security' (Wehrlé & Pohl, 2016; Sauvart, 2009). This means that authorities have had reasons to believe that, in some

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situations, FDI can be seen as a threat. A potential rationale behind this could be that, nowadays, countries take a more cautious approach towards international business and take economic measures to defend themselves against rivaling economies, as opposed to physical warfare. Clemens (2013) pointed out that, in the modern day, a great deal of geopolitical tactics are economic in times of conflict. In this case, sanctions can be taken to minimize the chance that adversary countries can do harm economically. It might be that host countries want to prevent companies based in certain countries from getting access to critical technologies or other special information. In addition, sanctions can also be used as a way of directly harming the economies of adversary countries. A topical example that is particularly relevant now is the reaction of the EU and the US to the war between Russia and Ukraine, which was already mentioned in the introduction. As a response to the invasion of Russia in Ukraine, the Biden administration decided to prohibit Americans to do business with the central bank of Russia and freeze the bank's assets in the US (Macias & Franck, 2022). The aforementioned review mechanisms, that can lead to the blockage of foreign direct investments, are more preventive examples of measures countries may take. In this paper, the triggers of these review mechanisms will be investigated. Moreover, I will research whether the military capability of a source country is related to the amount of reviewed, and therefore potentially blocked, acquisitions by the host country, suggesting that these review mechanisms indeed are put into place to in a way foster national security. It is this element that will be central in this thesis, because countries that are military competent pose the biggest potential threat in multiple ways. After all, these nations are the ones that have the available resources to put pressure on a rivaling economy. This entails that the military means of a country still is a reflection of the power it has, even when these means are not actively being used against notable economies. As a host country you would therefore not want these nations in particular to get access to important information such as critical technologies. This could further increase the power position these source countries have over the host country. Military capable countries will most likely refrain from going into physical warfare with each other for obvious reasons such as nuclear threats. However, could it be that, through preventive measures specifically taken against countries that have been known for their military power, military factors could be a trigger of the blockage of acquisitions by host countries? In addition, I will explore whether country-level characteristics such as the state legitimacy, as well as interstate features such as the number of military alliances and political relations between the source and host country, have an effect on the aforementioned relation.

This would further show that the use of these review mechanisms are influenced by geopolitical factors.

2.4 CFIUS

In this research the focus will be on the US as a host country. The committee that is responsible for the US review mechanism is The Committee of Foreign Investment in the United States (CFIUS), which is made up out of nine government agencies. Following the “Exon-Florio Amendment” in 1988, the review authority was delegated to CFIUS by the President. However, the authority to block or permit the transactions still remains with the President. The CFIUS process follows a few steps. When a foreign acquisition raises national security issues, the investment will be brought to the committee’s attention (CFIUS, n.d.). CFIUS proactively looks at all foreign investment activity and starts a review period when the committee deems this necessary. This review period will initially last 30 days but will be extended to 45 days if any of the nine involved agencies do not approve the proposed transaction. If there are still unresolved concerns after this period, a report will be sent to the President of the United States. The President can then decide to either block or allow the transaction. Overall, less than 10% of the incoming foreign investments are reviewed by the committee (Daly & Reynolds, 2009). In the next section I will hypothesize what might move CFIUS to specifically look at this minority of foreign investments.

2.5 Hypotheses

If the blockage of acquisitions indeed depends on military factors, then it could be that the military capability of a source country is positively related to the amount of reviewed transactions in the host country. If a country is more military capable, they could potentially be more of a threat to the national security of the host country. Even if countries abstain from going into physical war with each other, the military capability of a country in a way still reflects the power it has. For example, it could be that, in this case, the US is hesitant to give firms from military capable countries access to critical technologies or other important information. Less military capable source countries, however, are less dangerous to the US. Transactions from companies based in these countries would therefore be less likely to be reviewed.

Therefore, with regards to the relation between military capability and the amount of reviewed transactions in the US, the following hypothesis can be drafted:

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H1: The source country's military capability is positively related to the amount of reviewed transactions of that source country by the US

Hypothesis 1 is graphically presented in section I in the appendix at the end of this research paper.

To further investigate the research question, a closer look will be taken into the military alliances between the source and host country, the latter being the United States. Previous literature has found that military agreements between two countries foster their trade (Gowa, 1995; Mansfield & Bronson, 1997). Thus, economic interactions seem to be strengthened when countries have more military alliances between one another. Countries can be engaged in both bilateral and multilateral alliances. A bilateral alliance is a treaty between two countries, while a multilateral alliance is a treaty between multiple countries. The following operational definition for a military alliance is used in this thesis:

“written agreements, signed by official representatives of at least two independent states, that include promises to aid a partner in the event of military conflict, to remain neutral in the event of conflict, to refrain from military conflict from one another, or to consult/cooperate in the event of international crises that create a potential for military conflict.” (Leeds, Ritter, Mitchell & Long, 2002).

The amount of military alliances between the source and host country could have a moderating effect on the main relation described in hypothesis 1. The more the host country is engaged in military alliances with a source country, the less it presumably should worry about military threats from that country. In turn, the less it should be worried about military threats, the less transactions from that source country should be subject to reviews and therefore potentially blocked. Indeed, following the aforementioned definition, one of the main purposes of a military alliance is to refrain from military disputes. Thus, even though the military capability of a source country might be high, if it is engaged in more military alliances with the host country, it will not be perceived as much of a danger. Therefore, if the amount of military alliances between the host and source country is higher, the main effect between the military capability of the source country and the amount of reviewed transactions will likely be weaker. This makes up the second hypothesis of this thesis:

H2: The positive relation between the source country's military capability and the number of reviewed transactions is weaker when there are more military alliances between the source country and the US

Hypothesis 2 is graphically presented in section I in the appendix at the end of this research paper.

In addition to military alliances, political relations can have an effect on the main relation in this thesis as well. The influence of political relations on international business is a topic that has been researched by scholars before. For example, Kastner (2007) found that conflicting political interests between nations are damaging for their economic ties. Conversely, these ties are strengthened when political relations are strong. Moreover, Pollins (1989) argues that trade between countries is tied to their political economy. It can therefore be reasoned that political ties positively impact economic interaction between two countries. In addition, Werner (2000) explains that countries are less likely to be engaged in conflict when they are politically more aligned. Thus, if, following hypothesis 1, the military capability of source countries is indeed positively related to the blockage of acquisitions from their businesses in host countries, political relations could have a moderating effect. This means that if a source country has a high degree of political relations with the host country, the military capability of that source country will not influence the reviewed transactions of that nation as much. The reason for this is that even though the military capability of a source country might be high, the host country will not perceive that country as dangerous when they have strong political ties. After all, these politically aligned countries are less likely to pose a military threat to the host country. Therefore, the host country will be less hesitant to give firms from these countries access to specific national information such as critical technologies, even when these countries are military capable. Thus, if political ties are stronger, the main effect mentioned in hypothesis 1 is likely to be less positive. This makes up the third hypothesis of this thesis:

H3: The positive relation between the source country's military capability and the number of reviewed transactions is weaker when the political relations between the source country and the US are stronger

Hypothesis 3 is graphically presented in section I in the appendix at the end of this research paper.

Lastly, the influence of the state legitimacy of the source country will be investigated. If a source country's government is more legitimate, it can be argued that the danger of malpractice from that country is less apparent. For example, Khan (2009) found a link between domestic state legitimacy of countries and their engagement in international conflict. It can be argued that the state legitimacy of a source country has a moderating effect on the main relation described in hypothesis 1. If a source country is perceived as highly legitimate, the source country will recognize this nation as less dangerous, even when it is military capable. In contrast, when a source country is not perceived as legitimate, the military capability will be regarded as a concern by the host country. Thus, the degree of state legitimacy will presumably influence the main effect mentioned in hypothesis 1. Gilley (2006) found that the definition of state legitimacy can be tied down to three factors: a country's governance, rights such as gender equality and democracy, and welfare. These factors will also come back in the measurement of the variable legitimacy, which will be described later in this thesis. This makes up the fourth and final hypothesis:

H4: The positive relation between the source country's military capability and the number of reviewed transactions is weaker when the source country's state legitimacy is higher

2.6 Societal and scientific relevance

This research contributes in multiple ways, both societally and scientifically. As mentioned before, the blockage of acquisitions has not been empirically researched before. This means that, from a policy point of view, this paper can be an important contribution. The results of this research provides readers with an insight in the mechanics of the blockage of acquisitions. This is usually a topic that remains under the radar. This thesis therefore highlights what goes on behind the scenes of FDI. This paper tries to help with understanding what drives countries, in this case the US, to block acquisitions. In terms of societal implications, this research contributes as well. From a managerial point of view, it is important to know about all relevant risk factors regarding investments. One of these risk factors could be the potential blockage of an investment, which could lead to financial setbacks such as sunk costs. The researched relations in this thesis therefore might provide managers with information about factors that could lead to the blockage of these investments. It is important for managers to take these factors into account, despite the existing narrative the literature describes that host countries generally see FDI as a good thing.

3. Methodology and empirical strategy

To research the topic at hand, a panel data has been made up out of multiple data sources. As mentioned before, this thesis specifically focuses on the US as a host country. The US is a good country of analysis, since it is the biggest economy in the world and extensive data is accessible. With regards to the cross-sectional dimension, source countries that are covered in the CFIUS data have been investigated. Moreover, because of the availability of the data, the period from 2005 to 2017 has been researched. With regards to the blockage of acquisitions, CFIUS data is used. Military capability data has been retrieved from the SIPRI yearbook. In addition, for the military alliances moderator, data from the Alliance Treaty Obligations and Provisions (ATOP) are used. The political relations moderator is measured with voting similarity data from the United Nations. Lastly, data for the state legitimacy moderator has been retrieved from the Center for Systemic Peace database.

3.1 Dependent variable

The dependent variable in this thesis is *the amount of reviewed transactions*. As mentioned in the introduction of this paragraph, CFIUS data is used for this variable. In the CFIUS reports, country-level data is available with regards to the amount of reviewed transactions. The amount of reviewed transactions ultimately indicate how many foreign acquisitions potentially will be blocked by the US. If a lot of acquisitions from a specific source country are getting reviewed, this means that the US presumably has reason to distrust the intentions of their businesses.

3.2 Main independent variable

The main independent variable is the *military capability* of a source country. With regards to the military capability variable, data from the SIPRI database is used for this thesis. The SIPRI database contains country-level information on military expenditures. For this research, military spending per capita has been used. This is an appropriate way of measuring military capability, since this captures the relative military power of a source country the best. The more relative military power a country has, the more it can be seen as a military threat. Moreover, the first lag of this variable has been chosen for the models. This would make more sense, since the reaction from the US to the military spending of a source country in a certain year will likely not be immediate.

3.3 Moderating variables

The full model of this thesis consists of three moderators. The amount of *military alliances* is the first moderator. For the amount of military alliances, data has been used from the Alliance Treaty Obligations and Provisions (ATOP). This data includes information on the total number, both bilateral and multilateral, of military alliances the US is engaged in with a source country. The second moderating variable that has been researched is the *political relation* between the source country and the US. The United Nations have a database that includes the similarity index of votes between countries in the UN General Assembly. This adequately captures the political relations between countries, since it shows the extent to which countries are politically aligned with regards to foreign policy issues. In a general assembly session countries can either vote 'yes', 'no' or 'abstain' to approve of, disapprove of, or abstain from discussed issues. By comparing the votes of two countries, the voting similarity index between them can be computed. The third and final moderating variable, *state legitimacy*, is retrieved from the Center for Systemic Peace (CSP) database. As mentioned before, previous literature suggests that the legitimacy of a state can be boiled down to three factors: a country's governance, rights and welfare (Gilley, 2006). The state legitimacy measure in the CSP database is calculated as the sum of the security legitimacy, political legitimacy, economic legitimacy and social legitimacy. The social legitimacy captures the rights of a source country, the economic legitimacy captures the welfare, and the political legitimacy captures the governance. This way, the legitimacy moderator is adequately measured.

3.4 Control variables

Several source country-level control variables have been added to complete the model. The variable *total acquisitions* is added to control for the amount of acquisitions that are coming into the US from a source country. Data from the Thomson Reuter database is used for this variable. In addition, the *FDI inflow* variable is added to control for the total amount of FDI that the US receives from a source country on a yearly basis. For this variable, data from the Bureau of Economic Analysis is used. Both variables are added to account for a general FDI size effect. To control for the size of a source country the variable *population* is added. This is important because otherwise a potential size effect to the protectionism of the US could be ignored. Bigger countries could enjoy benefits from scale economies, which should be accounted for in the model. World Bank data is used for the incorporation of this variable.

Another variable that is based on World Bank data is *GDP per Capita*. This variable is used to account for the economic power of a source country. Furthermore, the variable *export dependence* is added to account for the effect of any potential reliance of the US on trade with a source country. Yearly data from the US Census Bureau makes up this variable. To complete the control set, a *state polity* is added to the model. This variable gives a numeric value to the civil government form of a source country. A higher polity score means that state is more democratic, rather than autocratic.

3.5 Empirical strategy

Because we are working with panel data, an according regression model should be used. To find out whether a fixed effects or random effects model is preferred a Hausman test is conducted. After that, the appropriate regressions are conducted to test the hypotheses. Because we are working with multiple moderators, incremental models are used. This means that one moderator is added at the time. Consequently, this thesis will consist of five models in total. Interaction terms between military capability and the three moderating variables are used in these models. To account for serial correlation, year dummies are incorporated in each of the models. With regards to hypothesis 1, a positive effect is expected between military expenses and reviewed transactions. With regards to hypothesis 2, 3 and 4 negative interaction terms are expected for the moderating variables. The models described in this section can be found in section II and III of the appendix at the end of this research paper.

4. Results

4.1 Correlations

The means, standard deviations and Pearson correlations can be found in Table 1. Even though multiple correlations are statistically significant, none of them are higher than $r=0.56$. It can therefore be concluded that none of the variables correlate too much with each other. This follows the logic of Senaviratna and Cooray (2019), who argue that multicollinearity becomes a serious problem when the correlation coefficient between two variables exceeds 0.8. This means that all variables can be used in the regression analysis.

TABLE 1
Descriptive Statistics and Correlations^a

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10
1. Reviewed Transactions	2.18	5.35										
2. Military Capability ^b	523.16	527.63	.1									
3. Military Alliances	1.76	0.65	.13	.18								
4. Political Relations	0.46	0.18	.22	.12	.25							
5. State Legitimacy	2.29	2.35	-.15	.04	-.01	-.54						
6. Total Acquisitions	34.98	37	.20	.11	.02	.16	-.22					
7. FDI Inflow	45,878	97,632	.56	.12	.25	.43	-.39	.24				
8. State Polity	5.79	6.37	.00	-.43	.14	.55	-.58	.19	.28			
9. Export Dependency	0.02	0.03	.43	-.04	.07	.14	-.12	.19	.37	.08		
10. Population	74,800,000	227,000,000	.31	-.23	-.16	-.21	.22	.13	-.06	-.13	.20	
11. GDP per Capita	31,069	24,527	.07	.44	.01	.39	-.49	.33	.41	.17	.17	-.29

^aCorrelations greater than |0.20| are significant at $p < .05$; those greater than |0.25| at $p < .01$; those greater than |0.32| at $p < .001$.

^bLagged variables ($t-1$).

4.2 Regressions

Because we are working with panel data, a Hausman test can be used to determine whether a fixed effects or random effects specification is justified. The test was done on the full model (model 5) and yielded a statistically significant result ($p < 0.001$). This means that fixed effects regression models will be used to test the hypotheses. The results of these models are presented in Table 2 and are all based on one-tailed hypothesis testing. The regressors in the models are all standardized by means of mean-centering.

TABLE 2*Results of Fixed Effects Regression Models for Reviewed Transactions^a*

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5
Year Dummies	Yes	Yes	Yes	Yes	Yes
Intercept	-.29 (.26)	-.12 (.26)	-.14 (.26)	-.46 (.29)	-.23 (.29)
Military Capability ^b	.75* (.31)	.96** (.31)	1.02** (.32)	.63 [†] (.32)	.99** (.33)
Military Alliances	-.29** (.10)	-.26** (.10)	-.28** (.10)	-.27** (.10)	-.23* (.10)
Political Relations ^b	.20 (.21)	.26 (.21)	.18 (.20)	.19 (.21)	.23 (.20)
State Legitimacy	.13 (.24)	.10 (.24)	.05 (.24)	-.05 (.28)	-.16 (.28)
Total Acquisitions	.07 (.05)	.05 (.05)	.07 (.05)	.06 (.05)	.05 (.05)
FDI Inflow	.39** (.15)	.41** (.14)	.44** (.14)	.39** (.15)	.44** (.14)
State Polity	.02 (.20)	.04 (.20)	.07 (.20)	.01 (.20)	.07 (.20)
Export Dependency	.17 (.32)	.21 (.32)	.07 (.32)	.21 (.32)	.17 (.32)
Population	5.00*** (1.37)	4.43** (1.37)	4.91*** (1.36)	5.14*** (1.38)	4.63** (1.37)
GDP per Capita	.47 (.56)	.25 (.56)	.25 (.56)	.48 (.56)	.12 (.56)
Military Capability × Military Alliances	–	-.33** (.11)	–	–	-.27* (.11)
Military Capability × Political Relations	–	–	-.32** (.12)	–	-.26* (.12)
Military Capability × State Legitimacy	–	–	–	-.37 (.32)	-.43 (.31)
R^2	.16	.18	.16	.16	.18
F	2.78	3.20	3.07	2.72	3.22

^a Standardized parameters are shown, with standard errors in parentheses.

^b Lagged variables ($t-1$).

[†] $p < .10$

* $p < .05$

** $p < .01$

*** $p < .001$

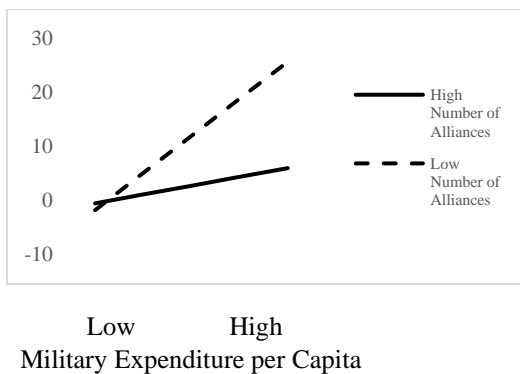
Military capability had a significant and positive relationship with the amount of reviewed transactions in all of the 5 models (model 1: $\beta = 0.75$, $p < .05$; model 4: $\beta = .63$, $p < .10$; model 2, 3 and 5: $\beta = .96$ to 1.02 , $p < .01$). Following the logic of Acock (2014), this can be seen as a strong effect. This supports the prediction made in hypothesis 1 that the source country's military capability is positively related to the amount of reviewed transactions from

that nation. With regards to the testing of the moderating effects, we can then look at the interaction effects that are included in the models. The interaction effect between military capability and military alliances is negative and significant in model 2 ($\beta = -.33, p < .01$). This can be seen as a moderate effect. This is in support of hypothesis 2, which suggests that the main relation between military capability and the amount of reviewed transactions is weaker when the number of military alliances is higher. This is also graphically presented in Figure 1A, which shows that countries with a low number of military alliances experience more reviewed acquisitions when their military capability increases.

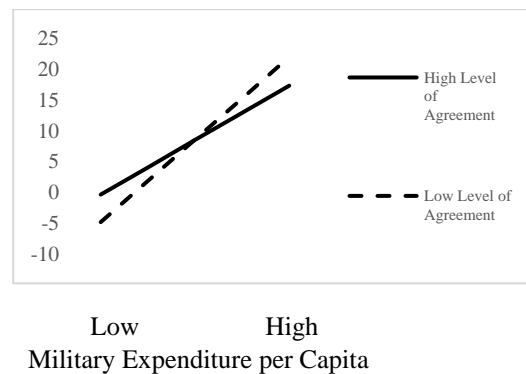
FIGURE 1

Interaction Plots for Moderating Effects on the Relationship between Military Capability and Reviewed Transactions

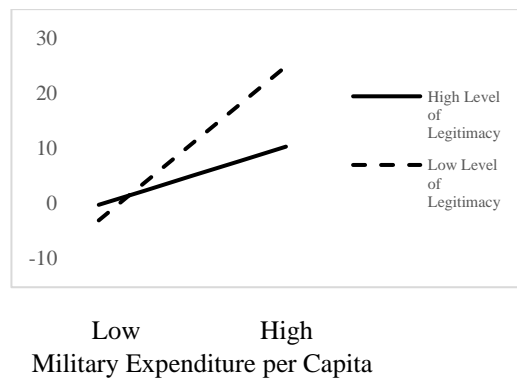
(1A) Military Alliances



(1B) Political Relations



(1C) State Legitimacy



Next, the interaction effect between military capability and political relations is tested in model 3. This outcome is negative and significant as well ($\beta = -.32, p < .01$), which supports the prediction made in hypothesis 3 that higher political relations weaken the effect between the military capability and the amount of reviewed transactions of a source country. This can be seen as a moderate effect. The interaction plot in Figure 1B shows that the line for

countries with a low level of agreement with the US is steeper. However, the lines are close, which indicates a weak effect. The interaction effect of military capability and state legitimacy was negative, but not significant. Therefore, no statistical evidence was found in support of hypothesis 4. Next, all the interaction terms were put together in model 5. In this model, the interaction between military capability and military alliances ($\beta = -.27, p < 0.05$) and the interaction between military capability and political relations ($\beta = -.26, p < 0.05$) both remained negative and significant. The effects can still be seen as moderate. The interaction between military capability and state legitimacy remained negative but insignificant.

5. Discussion

5.1 Implications

The current literature has mainly described incoming FDI to a country as a positive thing. Lipsey (2004) argued that there are 4 categories of positive effects a country may enjoy when foreign investments increase: wages, productivity, new industry introduction, and economic growth. This is why countries around the globe are actively trying to lure in FDI. Brewer & Young (1997) described that countries can do this through financial, fiscal and other forms of incentives. However, CFIUS data that is used in this paper shows that the US is yearly actively blocking a number of incoming acquisitions. No empirical research has been devoted to the question what moves a country to block FDI from coming in. CFIUS claims that when a foreign acquisition raises national security issues, the investment will be brought to the committee's attention (CFIUS, n.d.). It could therefore be that acquisitions from military capable source countries may be more frowned upon, even though scholars believe that FDI usually entails positive consequences. The results in this paper confirm this notion. If source countries have a higher military capability, their acquisitions are more likely to be reviewed and therefore blocked. Nowadays, big economies might want to refrain from physical warfare with military capable countries. However, this does not mean that these countries can protect themselves from military capable nations in other ways. This paper has shown that country-level military factors do have an impact on the mechanics of international business. The military capability of a country plays a role in a host country's decision to review, and potentially block, incoming foreign investments from that nation. Sauvart (2009) pointed out more than a decade ago already that there had been a rise in FDI protectionism. This paper has shown that this form of protectionism presumably still exists. Countries do not want rivalling economies to get access to their critical technologies and knowledge. Clemens (2013) argued that geopolitical conflicts are increasingly economic in the modern day. This paper investigated potential moderating effects that affect the aforementioned link between military capability and reviewed transactions. If geopolitical conflicts indeed are economic, alliances and diplomatic relations should have an influence on the blockage of acquisitions as well. After all, this would entail that international affiliations weaken the effect military capability has on reviewed transactions. Host countries do not worry as much about the power of a source country when they are related to, or allied with, them. This means that geopolitical forces influence the main relation researched in this paper. The results in this thesis confirm

these assumptions. The aforementioned positive relation between the military capability of a source country and the amount of reviewed transactions in the host country is weaker when the countries are engaged in more military alliances. This means that military factors have an even further impact on business dynamics. In addition to these factors, political ties influence the main relation as well. Kastner (2017) mentioned the influence that political interests have on economic relations. This paper empirically supports this argument. The positive relation between the military capability of a source country and the amount of reviewed transactions in the host country is weaker when the countries are more politically aligned. It has to be noted, however, that the moderating effect of political relations is weak, as seen in Figure 1B. The significance of these moderating effects puts the findings of the first hypothesis into a better perspective. It is not just the military capability of a source country that influences the blockage of acquisitions from said country. Military alliances and political relations play a part in this as well. The results do not provide evidence for the hypothesized moderating effect of state legitimacy. This means that, based on this paper, no conclusions can be drawn on the relation between the legitimacy of a state and the amount of blocked acquisitions in a host country. These findings contribute to the current literature, since no empirical research has ever been conducted with regards to the blockage of acquisitions. This paper provides an important antecedent, as well as moderating factors. From a managerial perspective this means several things. Managers ought to take risk-factors into account when assessing potential investments. Foreign investments, in particular, can be costly, meaning that wrong anticipations can lead to big sunk costs. The results of this paper provide managers with elements that influence the success of a foreign investment attempt. FDI protectionism adds another factor to the risk assessment of managers.

5.2 Limitations and future research

In this section the limitations of this research will be discussed, as well as recommendations for future research regarding this topic. In this paper the United States is used as the host country of analysis. It might be that other host countries have different kinds of review mechanisms. It could therefore be that different antecedents for the blockage of acquisitions are more prevalent for other host countries. Future research could focus on multiple host countries, so that the outcome can be better generalized. In addition, more antecedents for the blockage of acquisitions in general could be investigated. Furthermore, the data used in this paper covers a timespan up until 2017. It can be argued that a lot has happened since in the geopolitical arena. Examples of this are the war between Russia and Ukraine, and the trade

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war between China and the US. It would therefore be beneficial for future research to get access to even more recent data, in order to see whether the outcomes have changed. The blockage of FDI in general is a topic that has been ignored in scientific literature. This means that there are a great deal of undiscovered lanes with regards to this topic. For example, a more firm-specific approach could be taken to see whether businesses in certain industries are more likely to be denied foreign investments in a host country. The research model used in this paper can be used as a starting point for future research, however, there is still room for expansion.

6. Conclusion

All in all, this paper has shown that military factors play a role in the mechanics of foreign direct investment. Moreover, military relations, as well as political ties, between the source and host country influence the magnitude of the effect these military factors have. A great deal of the previous literature described some sort of utopia in which foreign direct investments bring positive effects to the host country, and therefore should be regarded as a good thing. The rise of FDI protectionism, however, seems to be at the base of a more cautious approach countries take with regards to inward foreign investments. Consequently, managers should realize that host countries will not always be willing to approve any investments coming in from abroad. This means that country-level military factors and political ties should be considered as a risk factor when assessing a business opportunity abroad. Overall, it is clear that this topic is under investigated, which means that the discussion does not end here. Little to no research exists regarding the blockage of foreign acquisitions and its antecedents. It would therefore be a good thing if the topic of negative FDI perceptions would be more empirically researched in the future. That way, from a managerial perspective, the dynamics of FDI will become more clear and risks such as sunk costs can be avoided.

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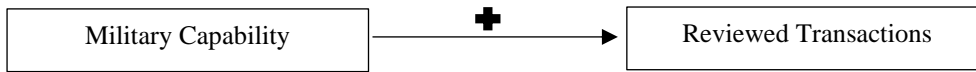
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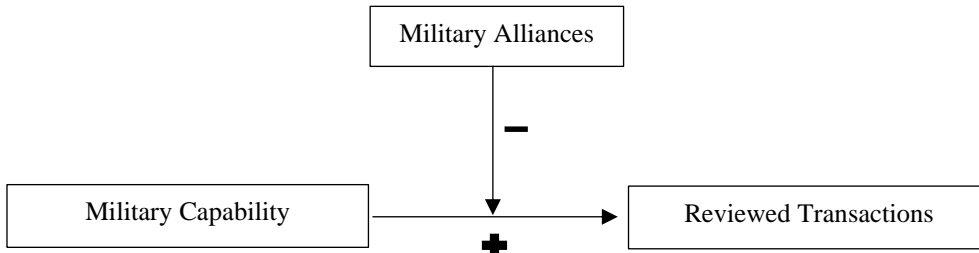
Barriers to FDI: Analyzing the role of geopolitical factors in the host country's decision to block foreign acquisitions

Appendix

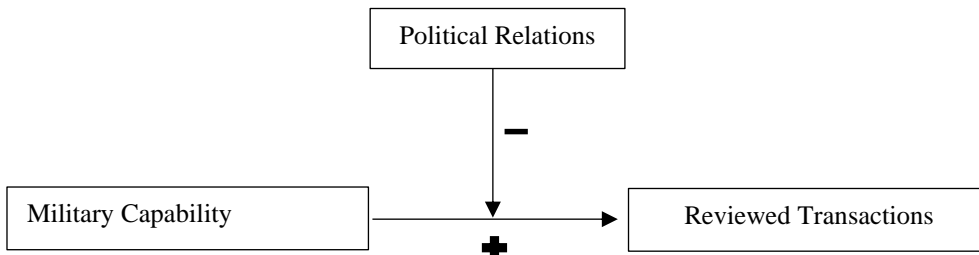
I. Framework of hypothesis 1 and 2



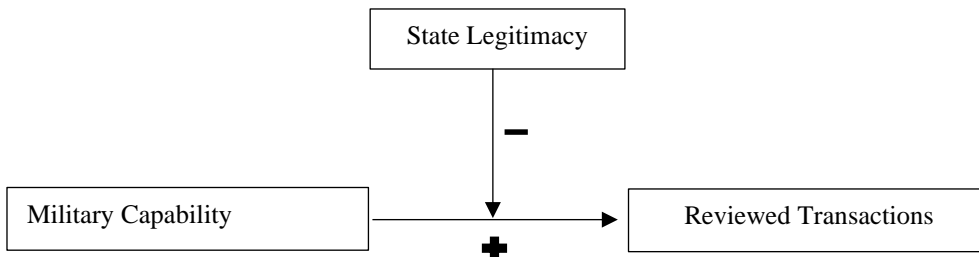
Hypothesis 1



Hypothesis 2



Hypothesis 3



Hypothesis 4

II. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
cover_trans	754	2.180371	5.354556	0	60
mil_exp_pe~p L1.	664	523.1644	527.6277	4.824404	2762.793
number	537	1.759777	.6493556	1	4
agree L1.	684	.4563263	.1761172	0	.9516129
legit	702	2.289174	2.352738	0	8
total_acquis	858	34.97902	37.00383	1	114
FDI_inflow	701	45877.55	97632.44	-13030	522954
polity2	702	5.794872	6.365526	-10	10
export_dep~y	819	.015873	.0341966	8.49e-06	.2525997
pop_home	819	7.48e+07	2.27e+08	23107	1.39e+09
GDP_pc	777	31069.49	24527.04	934.3919	141200.4

III. Hausman Test

Test: Ho: difference in coefficients not systematic

```

chi2(16) = (b-B)'[(V_b-V_B)^(-1)](b-B)
          =      72.47
Prob>chi2 =      0.0000
(V_b-V_B is not positive definite)
    
```