Whose greed, whose grievance, and whose opportunity? Effects of foreign direct investments (FDI) on internal conflict

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A B S T R A C T
This paper investigates the influence of foreign direct investments on the probability of civil conflict onset, contributing to the debate on globalization and civil conflict. I relax the common assumption that all forms of globalization are equivalent in their effects on civil conflict. I also incorporate the cross-sectoral heterogeneity of investments in existing arguments about the socioeconomic externalities of foreign direct investments as determinants of conflict. With long time horizons and managerial control of their foreign affiliates, foreign direct investors are strategic players aiming to maximize profits and uniquely able to alter their environment through socio-political channels. This distinguishes FDI from trade and foreign portfolio investments. Through a combination of political agency and socio-economic influences on grievance and greed among domestic groups, some types of FDI are likely to alleviate the risk of civil conflict (service sector FDI), while others exacerbate it (primary sector FDI). Analyses using a new data set of sector-specific FDI stock, 1980–2013, lend empirical support to the argument. Showing that economic globalization can have simultaneous positive and negative externalities, these findings are informative for the current dialogue on the role of global markets in sustainable development.

1. Introduction

Although the incidence and destructiveness of violent disputes has decreased since the end of the Cold War (Gleditsch, Melander, & Urdal, 2015), civil conflict remains a tragedy of the 21st century. Most such conflicts occur in poor countries and tend to be internal, low-intensity conflagrations that last many years (Martin, Mayer, & Thoenig, 2008). This type of violence has damming consequences at both the micro and the macro level in the countries where it is located (Thyne, 2015) and it also spills across national borders (Forsberg, 2015). It comes as no surprise, then, that civil conflict has been the focus of extensive research in International Relations. The effects of globalization, however, have received comparatively little attention in this literature, despite the unprecedented increases in global economic integration in the past four decades (Sorens & Ruger, 2014). At the same time, in the “peace through globalization” debate, the focus on domestic peace is sparse (Schneider, 2014). Furthermore, in this relatively small body of work, findings range from globalization as a facilitator of civil conflict (e.g., Olzak, 2011) to globalization as a boon for peace (e.g., Barbieri & Reuveny, 2005; Blanton & Apodaca, 2007; Bussmann & Schneider, 2007) and the question of the impact of globalization on internal violence remains open.

To advance the debate on the relationship between globalization and civil conflict, this study extends existing work in two important ways. First, it relaxes the assumption that all forms of globalization are equal in their effects on civil conflict. By acknowledging that foreign direct investment (FDI) is formally and functionally different from other types of cross-border economic flows, this study begins to fill an important gap in the globalization and civil conflict literature, which has afforded comparatively little theoretical and empirical attention to FDI. It takes to heart the still-valid observation by Gissinger and Gleditsch (1999), that “it is generally taken for granted that the process of economic integration has the same consequences regardless of the type of economic integration” (346).

Second, it recognizes the heterogeneity of FDI theoretically and empirically, developing an argument and offering a novel data set of sector-specific FDI stock. In the existing literature, even those studies that differentiate empirically among the various forms of globalization—FDI, foreign portfolio investment (FPI), trade—tend to treat FDI as a monolithic pile of cash transferred to the host country and reach contradictory conclusions regarding its effects (Barbieri & Reuveny, 2005; Blanton & Apodaca, 2007; Bussmann & Schneider, 2007).

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By relaxing the assumption that all forms of globalization are equivalent in their effects on civil conflict, the argument here articulates the potential for political agency of foreign direct investors. Multinational corporations (MNCs) have long-term interests in their host countries and assume managerial control of their foreign affiliates, which stands in contrast with the short-term horizons of FPI and the arms-lengths contracting of export-import operations (UNCTAD, 2016a). In the process of risk assessment and management, foreign direct investors engage actively with host communities, governments, and non-governmental organizations (e.g., Bouwen, 2002; Coen, 1997; Conway, 2013; Hadjikhanli & Ghauri, 2001; Hain, 2011; Hiscox, 2001) and take direct actions to alter their political environment. Nonetheless, while all investors have the potential for direct influence on civil conflict outcomes, only some will find it efficient to cooperate among themselves toward this goal.

Furthermore, this paper incorporates the cross-sectoral heterogeneity of investments in the existing arguments about the socio-economic externalities of FDI as channels for influencing conflict. As others have noted, investors wield the power to transform the economies of developing countries, thus changing economic, social, and political incentives and capacities. Investors thus create, eliminate, or mitigate reasons for grievance and exacerbate or alleviate greed among domestic groups (e.g., de Soysa & Oneal, 1999; Kosack & Tobin, 2006; Reuveny & Li, 2003). These developmental externalities of FDI depend on the nature of investment projects and vary across the three economic sectors—primary, secondary (manufacturing), and tertiary (services) (Alfar, 2003; Ayukt & Sayek, 2007; Chakraborty & Nunnenkamp, 2008; Mihalache & Li, 2011). In the context of civil conflict, this means that different types of FDI likely have different implications for a country’s vulnerability to political violence. Recent interdisciplinary work on development and civil conflict (e.g., Boone, 2017; Cramer, 2003; di John, 2007; Fearon & Laitin, 2011; Nelson, 2012) makes it possible to take a more nuanced approach to the question and to differentiate these effects of FDI across sectors.

On the empirical side, the models here distinguish the effects of FDI penetration across the three economic sectors, using an updated data set of sector-specific FDI stock in developing countries, 1980–2013. Analyses using these data support the predictions that primary sector FDI (PFDI) penetration increases the probability of civil conflict onset, while FDI in the tertiary sector (TFDI) reduces it. The effect of secondary sector FDI (SFDI) on civil conflict is theoretically indeterminate and the analyses do not reveal significant effects of SFDI on conflict, either. Overall, there is evidence that modernization- and dependency-style effects can co-exist in a country. While it is important and parsimonious to ask how globalization, as a whole, affects developing countries, it is not entirely without merit to understand how each of the diverse processes, flows, and exchanges we collectively dub globalization matters, especially since globalization does not function as a block.

These theoretical and empirical contributions complement the existing literature (e.g., Barbieri & Reuveny, 2005; Blanton & Apodaca, 2007; Gissinger & Gleditsch, 1999; Hegre et al., 2002; Olzak, 2011; Sorens & Ruger, 2014), as they offer a possible explanation for the wide range of findings with respect to the effects of total FDI on civil conflict. Being explicit about both the economic impacts and the political agency of foreign direct investors, while also accounting for the different consequences of heterogeneous investment projects, allows for the articulation of sector-specific expectations regarding the effects of FDI on conflict. When total FDI is included in the models, rather than sector-specific FDI, the divergent effects of the different sectors cancel each other out, or, if a significant effect is observed, it is the artifact of the sectoral and industrial composition of FDI. These insights also have practical implications for national development strategies, investment promotion agencies, and global peace and security initiatives. The paper proceeds as follows. Section two summarizes the literature on globalization and civil conflict. Section three introduces an argument that links FDI in different economic sectors to the onset of civil conflict and derives three sector-specific testable propositions. Section four describes the research design and section five presents the empirical results. The final section concludes.

2. The literature on globalization and civil conflict: Room for a more careful look at FDI

If curious about the effects of MNCs on domestic peace, the natural starting point is the budding literature on globalization and civil conflict. Scholarly interest in this topic has grown over the past two decades, as the incidence of civil conflict has increased simultaneously with the intensification and diversification of cross-border economic flows.1 Existing studies have in common a basic conceptualization of economic globalization, which typically includes trade and foreign direct investment2. The economic flows that constitute globalisation are treated as equivalent in their consequences for domestic peace, the effects of trade and FDI assumed to be indistinguishable from each other. Furthermore, the arguments treat FDI (and globalization, too) as a homogenous unit that, as a whole, is either detrimental or beneficial to the host country. Based on these assumptions, globalization is argued to have a set of socio-economic externalities and/or political externalities—i.e., unintended consequences—with the potential to affect the probability of civil conflict. These approaches focus on the behavior of societal groups and states, discounting the agency of the foreign investors. Predicted effects divide along Liberal-Structuralist lines.

The socio-economic externalities of globalization have received most of the attention (Barbieri & Reuveny, 2005; Bussmann & Schneider, 2007; de Soysa & Fjølde, 2010; Gissinger & Gleditsch, 1999; Hegre et al., 2002; Magee & Massoud, 2011; Olzak, 2011; Sorens & Ruger, 2014). In this perspective, the would-be rebels are the principal agents of change and globalization connects to civil conflict through greed/grievance mechanisms, its effects best predicted with arguments situated in the Liberal-Structuralist debate. The Liberal position expects globalization to be a boon to domestic peace. The economic linkages among countries increase the efficiency of domestic production, capital allocation, and redistribution (Rostow, 1980), speeding economic growth and, ultimately, creating welfare externalities for the entire population (Barbieri & Reuveny, 2005). These developments eliminate the greed motive as they render rebellion unprofitable (e.g., de Soysa & Fjølde, 2010; Hegre et al., 2002; Sorens & Ruger, 2014).

1 Over the past four decades, the importance of FDI to the global economy has increased dramatically. For example, according to the World Investment Report (UNCTAD, 2016b), FDI inflows to developed countries in 2015 almost doubled (to $962 billion) relative to the 2014 level, while developing countries received $775 billion, up 9 percent since 2014 and more than double the 2005 level. By 2005, FDI flows into developing countries as a share of their GDP had risen from only 10% in 1980 to approximately one third. Furthermore, more than 60% of international trade takes place within, rather than among, multinational corporations (i.e., intra-firm trade) (UNCTAD, 2006a, 2006b).

2 There are some variations to this definition. Even when studies define economic globalization to include foreign portfolio investment and labor migration, the theoretical and empirical focus remains on trade/FDI (e.g., CITE). A few studies extend the definition of globalization to include transnational exchanges of information (CITE), the spread of particular policies and ideas (e.g., de Soysa & Fjølde, 2010), and foreign portfolio investments (e.g., Sorens & Ruger, 2014).
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