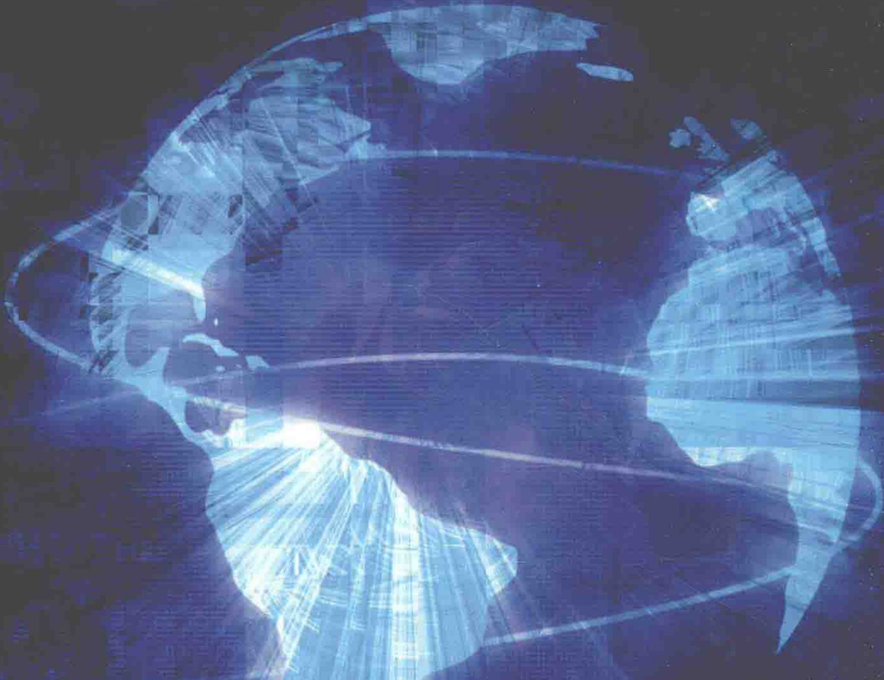
Trading Spaces

Foreign Direct Investment Regulation, 1970–2000



Sonal S. Pandya

POLITICAL ECONOMY OF INSTITUTIONS AND DECISIONS

CAMBRIDGE

Trading Spaces

Foreign Direct Investment Regulation, 1970–2000

SONAL S. PANDYA
University of Virginia

CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE
UNIVERSITY PRESS

32 Avenue of the Americas, New York, NY 10013-2473, USA

Cambridge University Press is part of the University of Cambridge.

It furthers the University's mission by disseminating knowledge in the pursuit of education, learning, and research at the highest international levels of excellence.

www.cambridge.org
Information on this title: www.cambridge.org/9781107040342

First published 2014

Printed in the United States of America

A catalog record for this publication is available from the British Library.

Library of Congress Cataloging in Publication data
Pandya, Sonal S. Trading spaces : foreign direct investment regulation, 1970–2000 / Sonal S. Pandya.
pages cm. – (Political economy of institutions and decisions)
Includes bibliographical references and index.
ISBN 978-1-107-04034-2 (hardback)
1. Investments, Foreign. 2. Investments, Foreign–Political aspects. I. Title.
HG4538.P35 2014
332.67'3–dc23 2013018645

ISBN 978-1-107-04034-2 Hardback

Preface and Acknowledgments

My interest in foreign direct investment (FDI) began, as much research does, with a naïve question: Why do countries restrict inward FDI? When I was a graduate student, the cutting-edge research in international political economy drew extensively from economics to derive testable claims about the political economy of international trade and monetary policy. FDI, however, was seldom mentioned. I had written my undergraduate thesis on telecommunications liberalization in the World Trade Organization, an area in which market access for multinational firms is a key issue. FDI seemed very important to global economic integration but it was strangely absent from the current political economy research. From my perspective as a third-year PhD student existing political economy theories of FDI were far from the cutting-edge research to which I aspired. So, motivated by my naïve question, I hatched an equally naïve plan: to study FDI the same way that everyone studies trade and money – that is, to develop and test explanations for countries' policies based on a rigorous account of FDI's economic consequences.

Now, nearly a decade later, I can report that there were very good reasons why political economy scholars had not studied FDI in this way. In order to do this research I had to confront two significant obstacles. First, there is no standard definition of FDI regulation, let alone readily available data on regulations. I had to pin down what exactly it means to restrict inward FDI and how to measure those restrictions. Second, I had to develop a tractable way of theorizing about FDI and its economic consequences. FDI encompasses virtually all industries from agriculture to advanced manufacturing to high-skill services like banking and law. There were no pithy economic models of FDI from which I could borrow. The challenge I faced was how to develop a theoretical framework that would produce meaningful insights across such a wide range of economic activities. As this book attests, I did eventually figure out how to address these obstacles. My naiveté turned out to be a blessing. I may not have pursued this research had I fully grasped these challenges at the outset.

While I think this book is a reasonably convincing answer to my initial question, the process of writing actually produced the more valuable rewards. It has changed how I think about international economic integration. In thinking about what makes FDI distinctive as a form of economic activity, I came to appreciate how the organization of economic activity across firms and national borders, in and of itself, has far-reaching consequences for economic growth and development. With this recognition I began to gravitate toward what had seemed like the minutiae of economic activity – the structure of firms, the precise characteristics of productive assets – and uncovered even more engaging questions about the causes and consequences of international economic integration.

I am deeply indebted to the many people and institutions whose support made this research possible. Perhaps my largest debt is to my dissertation advisor Jeff Frieden. My doctoral dissertation was the earliest incarnation of this book. Among many other things, Jeff taught me how to think systematically, especially while navigating uncharted intellectual territory. When I grew frustrated, he never failed to remind me "if it were easy someone would have done it already." These gifts of creativity and tenacity are priceless, and I am enormously grateful to Jeff for sharing them with me.

The other members of my dissertation committee offered thoughtful guidance throughout. Bob Bates shared his extensive knowledge of early FDI research and encouraged me to think about the consequences of my findings for economic development. Mike Hiscox helped me apply insights from trade policy to the study of FDI and convinced me to undertake the large data collection effort necessary to do this research. Torben Iversen introduced me to the idea that the organization of economic activity is of both political and economic consequence and helped me think about what that meant for the politics of FDI.

I had the great fortune to join the faculty of the University of Virginia at the same time David Leblang did. Every assistant professor should be so lucky to have a senior colleague like him. David is unfailingly generous with his time, advice, and enthusiasm. He read and commented on an early iteration of this book's manuscript and read many sections of subsequent drafts. As collaborators on subsequent projects, we have worked together to implement some of the ideas initially inspired by this book. I especially appreciate David's willingness to entertain some of my zanier research ideas that reach far into distant disciplines.

Over the many years I have worked on this research, several people have provided thoughtful feedback and suggestions: Jim Alt, Patrick Hanberry, James Harrigan, Nate Jensen, Mike Kellermann, Quan Li, Carol Mershon, Sachin Pandya, Pablo Pinto, Ken Scheve, Beth Simmons, and Robert Urbatch. Xun Cao and Jim Vreeland generously shared their data with me. Kishore Gawande, John Echeverri-Gent, Jeff Legro, David Leblang, and Lisa Martin read an early draft of the full manuscript and generously spent an entire day discussing it with me. Two anonymous reviewers for Cambridge University Press provided numerous suggestions that markedly improved the final product.

Several colleagues, past and present, provided support and encouragement in innumerable ways: Randy Akee, Ben Ansell, Dorothe Bach, Mark Copelovitch, Alison Criss, Asif Efrat, Tobias Hoffmann, SeoYoon Kim, Nathan Paxton, Sandra Sequiera, Catherine Thomas, Robert Urbatch, Alex Wagner, Gay Wehrli, and Joanna Lee Williams. David Andrew Singer has always been a particularly ready source of advice.

I am tremendously grateful to the several institutions and organizations that facilitated this research. Harvard's Weatherhead Center for International Affairs provided me with a warm and congenial environment when I was a graduate student. The Weatherhead Center also provided financial support, as did Harvard's Institute for Quantitative Social Science and Center for European Studies. In the year following graduate school, Princeton's Niehaus Center for Globalization and Governance, and its director Helen Milner, gave me the precious gifts of time and a vibrant community of like-minded scholars that eased the transition from graduate student to assistant professor. The University of Virginia's Bankard Fund for Political Economy generously supported the final stages of this research. Scott Parris, my editor at Cambridge University Press, provided sage advice throughout the publication process. His assistant, Kristin Purdy, was unfailingly helpful and ensured that the production process went smoothly.

My friends and family made this all possible in more ways than I can even begin to describe: Barbara de Lara Aguilar, Julian Blake, Peter Bruland, Arthi Chakravarthy, Katie Furman, Patrick Hanberry, Minona Heaviland, Shenandoah Joe, Anya Kapoor, Rahul Kapoor, Sachin Pandya, Sophia Pandya, Jessica Sager, Sheetal Sekhri, Kartini Shastry, Vidya Sundaram, and Jennifer Tromberg. I extend extra special thanks to my father Sharad Pandya for a lifetime of love, support, and encouragement to be aware of and curious about the world around me.

Contents

List of Figures		*page* ix
List of Tables		x
Preface and Acknowledgments		xi
1	Introduction: The Politics of FDI Regulation in the Twentieth Century	1
	1.1 The Politicization of FDI Inflows: A Brief History	4
	1.2 FDI Liberalization: Identifying Empirical Puzzles	8
	1.3 The Political Economy of FDI Regulation: Theoretical Claims and Empirical Tests	13
	1.4 New Perspectives on the Political Economy of FDI	16
	1.5 Roadmap	18
2	FDI: Why Companies Invest and Countries Restrict	21
	2.1 Why Does FDI Exist?	25
	2.1.1 FDI Protects Firm-Specific Assets	25
	2.1.2 What Firms Become Multinational Corporations?	28
	2.1.3 Export-Oriented versus Market-Oriented FDI: The Organization of Multinational Production	30
	2.2 The Distributive Effects of FDI Inflows: Implications of the Specific Factors Model	37
	2.2.1 Accounting for Alternate Mechanisms	39
	2.3 FDI Preferences: Increased Labor Demand and Returns to Skills	42
	2.4 Sources of Cross-National Variation: Political Regime Type	44
	2.5 Sources of Cross-Industry Variation: Organization of Production	47
	2.6 Conclusion	50

3 FDI Regulation Weakens Control over Assets 52
3.1 Instruments of FDI Regulation 52
3.2 Why Local Capital Owners Profit from Restrictions on Foreign Ownership 58
3.3 Ownership Regulations Reduce FDI Inflows 63
3.4 Conclusion 68

4 Individual Preferences for FDI Inflows 69
4.1 Modeling Preferences: Comparing Economic and Noneconomic Factors 71
4.2 Explaining FDI Preferences: Empirical Tests 74
4.3 Conclusion 86

5 Democratization and Cross-National FDI Liberalization 88
5.1 Democratization and Foreign Ownership Liberalization: A Baseline Model 91
5.2 Robustness to Alternate Explanations for FDI Liberalization 94
5.3 Alternate Measures and Model Specifications 100
5.4 Robustness Tests 101
5.5 Conclusion 105
Appendix 107

6 The Organization of Multinational Production and Cross-Industry Variation in FDI Regulation 109
6.1 Modeling the Frequency of Industry-Level Ownership Restrictions 115
6.2 Industry-Level Regulation – Robustness Tests 124
6.3 Conclusion 126
Appendix 128

7 The Politics of FDI in the Twenty-First Century 129
7.1 Advancing FDI Research 131
7.2 FDI and the Twenty-First-Century Global Economy 134

Appendix: Existing and New Measures of FDI Regulation 139

Bibliography 153

Index 169

Figures

1.1 Global average foreign-ownership restrictions and FDI stock, 1970–2000 — *page* 9
1.2 Average level of foreign ownership restriction, advanced versus developing countries — 11
1.3 Foreign ownership regulation and democracy, by region — 12
2.1 Growth in export-oriented FDI in U.S. computer-hardware MNCs, 1977–2000 — 36
2.2 Trade and FDI flows by country income group, 1960–2000 — 37
3.1 Global average foreign-ownership restrictions, formal versus informal barriers, 1970–2000 — 58
5.1 Democratization coincides with foreign ownership liberalization — 90
5.2 Average foreign ownership restrictions, autocracies versus democracies — 92
6.1 Growth in export-oriented FDI in manufacturing by U.S. firms, 1983–2000 — 111
6.2 Industry FDI market orientation, 1977 versus 1999 — 114
6.3 Predicted counts of restricting countries — 123

Tables

1.1 Frequency of industry-level foreign-ownership restrictions, 1978 versus 2000 *page* 13
3.1 Summary statistics 65
3.2 Data definitions and sources 66
3.3 Determinants of FDI volume 67
4.1 Summary statistics 78
4.2 Baseline results 80
4.3 Alternate measures of returns to FDI 82
4.4 FDI preference, disaggregated education measure 83
4.5 Expanded models of FDI preferences 85
5.1 Summary statistics 93
5.2 Democratization and FDI liberalization, formal and informal barriers 94
5.3 Average effect of democracy on ownership liberalization during economic crises 97
5.4 External sources of foreign-ownership liberalization: coercion, learning, and imitation 99
5.5 Alternate measure of democracy, *Polity Score-Binary* 102
5.6 Average effect of democracy on ownership liberalization (Polity Score Measure) 104
5.7 Instrument for democracy: years since independence 105
6.1 Growth of export-oriented FDI, 1977–1999 112
6.2 Cross-industry distribution of FDI regulation, 2000 119
6.3 Summary statistics 121
6.4 Sources of cross-industry variation in foreign-ownership restrictions 122
6.5 Sources of cross-industry variation in informal FDI regulations 125
A1 Countries in dataset, by region 148
A2 Industries in full FDI regulation dataset 149

1

Introduction

The Politics of FDI Regulation in the Twentieth Century

Foreign direct investment (FDI) are investments that corporations make to produce goods and services in foreign countries. For example, these are the investments that a manufacturing firm makes when it relocates factories abroad, an oil company makes to drill for oil overseas, or a bank makes when it purchases a bank based in a foreign country.

FDI is the lynchpin of today's global economy, because it is the single largest form of international capital flow. In many years, the total value of world FDI flows exceeds the total value of all other forms of cross-border capital flows combined (UNCTAD 2012). Multinational corporations (MNCs) also create a significant portion of global trade. In the 1990s, MNCs generated 90 percent of all U.S. trade (Bernard, Jensen, and Schott 2009: 536). Intrafirm trade – trade between subsidiaries of the same MNC – accounts for more than a third of total world trade (Yi 2003, Bernard, Jensen, Redding, and Schott 2012).

FDI also figures prominently in some of the most pressing challenges and opportunities that global economic integration presents. FDI is unparalleled in its potential to foster economic development. When MNCs produce abroad, they provide a conduit for the specialized technologies and skills that are critical to industrialization (Romer 1993). During economic crises, including the 2008 global financial crisis, MNCs tend to increase stability, expanding production while their local counterparts fold (Desai, Foley, and Forbes 2008, Alfaro and Chen 2012).

There are, however, prominent examples of MNCs that appear to have run roughshod over national laws, and even basic human rights, to pursue resources and profits. A 1984 gas leak at a Union Carbide plant in Bhopal, India, left thousands of people dead and hundreds of thousands injured. Decades later, litigation over Union Carbide's negligence continued in both

Indian and U.S. courts. In 2012, the U.S. Supreme Court heard the case of twelve Nigerian citizens who alleged that the multinational oil company Royal Dutch Petroleum aided and abetted torture and extrajudicial killings by the Nigerian government. It eventually ruled in favor of Royal Dutch Petroleum.[1] Although these are extreme examples, they represent a larger class of concerns about how MNCs use their vast resources and influence, and how national laws cannot adequately hold MNCs accountable for their actions.

Political economy research on FDI has long focused on how politics influences patterns of FDI inflows across countries. Put differently, existing research emphasizes questions of FDI supply: How does politics factor into MNCs' location decisions? How do domestic political characteristics systematically influence the expected profits of FDI in a given host country? When investors own firms in foreign countries, they contend with political risk, the risk that host governments will change regulations, enforce contracts poorly, expropriate assets, or otherwise act to lower investment returns. Examining the politics of FDI from the perspective of MNCs, current FDI scholarship seeks to identify the host country characteristics that correspond to higher risks (Jensen et al. 2012). This research generally treats FDI as something of a black box, giving little regard to the specifics of MNCs' production and sales activities in host countries. Similarly, empirical analyses almost uniformly characterize FDI only by estimates of its monetary value.

In this book, I analyze how and why countries regulate FDI inflows. By contrast to existing research, my focus is on the politics of FDI demand: Why do countries restrict FDI inflows? Why are FDI restrictions more common in certain industries? Under what circumstances do countries dismantle regulations to provide MNCs greater access to their economy? These questions come from the perspective of citizens and national policy makers in host countries, not the investing MNCs. To answer these questions, I open up the black box of FDI to examine MNCs' specific economic activities and how those activities affect host countries.

FDI's economic consequences derive from the firm-specific economic assets that MNCs introduce into the countries in which they invest. These assets include production technologies, production practices, and consumer brands that the firm itself develops. MNCs engage in FDI to expand their production and sales into foreign markets while maintaining control over these assets. Firms for whom it is profitable to become multinational

[1] Kiobel v. Royal Dutch Petroleum Co., 133 S.Ct. 1659 2013.

through FDI are firms whose assets confer exceptional productivity advantages. Indeed, MNCs are typically the world's most productive firms in their respective industries.

My theory of FDI regulation identifies how MNCs' production and sales activities redistribute income within host countries by increasing labor demand, and competing with local firms. National policy makers regulate FDI inflows to mitigate the expected costs to local firms. The most prevalent form of FDI regulation requires MNCs to form partnerships with local firms in which the local partner is the majority shareholder. These ownership restrictions facilitate local firms' access to MNCs' highly productive economic assets and the income they generate.

To test my claims, I use an original dataset of annual country-industry foreign ownership regulations that spans more than 100 countries during the 1970–2000 period. While there are multiple types of FDI policy instruments, ownership restrictions are the most ubiquitous form of FDI regulation across countries and industries. To the best of my knowledge, this is the most comprehensive dataset of formal national FDI regulations ever collected. With this data, I show why countries vary in how often they regulate FDI during the last third of the twentieth century.

This research contributes to our understanding of FDI policies and the politics of international economic integration more generally. For FDI specifically, it highlights the political underpinnings of the dramatic FDI liberalization during the 1970–2000 period, the liberalization responsible for FDI's prominent and varied role in economic integration today. Further, by identifying politically salient variation in the content of investments, this research resolves an apparent contradiction in the politics of FDI: the presence of both vociferous opposition to FDI and extensive efforts to attract FDI inflows. In addition to providing a theory of FDI demand, my research suggests new and better tests of political risk theories. These tests that emphasize variation across MNCs in their vulnerability and sensitivity to risk as much as they do variation in host-country sources of risk.

This research also situates the political economy of FDI in the context of larger structural transformations of the world economy. FDI liberalization is a microcosm of fundamental shifts in both the scope of political representation within countries and the global organization of economic activity that took place during the last third of the twentieth century. Democratization, and the accompanying expansion of political representation, prompted policy makers to reassess their countries' engagement in the global economy. Simultaneously, the emergence of multi-country production networks altered the costs and benefits of economic integration.

The book also provides insights into the unfolding politics of FDI in the twenty-first century. FDI features prominently in the relationship between advanced industrialized economies and large emerging-markets like China, India, and Brazil. FDI contributes heavily to the remarkable growth of these developing countries, particularly China. Investments to produce goods for export draw these countries into global production networks in which individual MNCs fragment their production of a single good across multiple countries. Through these networks developing countries gain high-quality manufacturing jobs and augment their industrial capacities.

FDI, however, also generates some of the sharpest economic policy tensions between advanced and emerging economies. While emerging-market countries welcome FDI that produces goods for export, they frequently restrict foreign MNCs' access to the local consumer market. Robust growth in these large countries makes them attractive destinations for MNCs seeking to produce and sell goods and services to their citizens. In response, emerging markets often reaffirm foreign ownership restrictions in non-traded service industries like retailing, finance, and telecommunications where MNCs pose a particularly large and direct competitive threat to local firms in the same industries. At the same time, MNCs based in emerging markets face increasing hostility toward their FDI into advanced economies. As developing countries' economies rapidly ascend, some of their largest firms have become MNCs, albeit frequently with subsidies from their national governments. In response to these investments, the world's most advanced economies are reassessing their policies, citing both economic and national security concerns, despite, in many cases, their having long been open to FDI.

These trends suggest that FDI remains as politically contentious as ever notwithstanding the decline in average levels of formal restrictions in recent decades. To understand today's global economy, we need to understand FDI's winners and losers and the evolution of FDI policies. In the concluding chapter, I return to the question of FDI's politics in the twenty-first century to discuss how this book's findings illuminate current and likely future controversies about FDI's roles in the global economy.

1.1 The Politicization of FDI Inflows: A Brief History

FDI is an artifact of modern industrial production, and in particular the central role of intellectual property that emerged in the early twentieth century (Chandler 1962). At the close the nineteenth century, FDI comprised an estimated 10 percent of global capital flows and was concentrated in infrastructure and natural resource extraction.[2] These investments flowed from major western European economies to their colonies and independent countries in the Americas (Teichova, Lévy-Leboyer, and Nussbaum 1986). Countries imposed few limits on FDI inflows. If anything, there were concerns in FDI source countries about dwindling investment capital for the domestic market.[3]

In the early twentieth century, private firms invested more heavily to create intellectual property through research, development, and marketing. Between 1921 and 1946, scientific personnel as a share of U.S. industrial employment increased sevenfold, because manufacturing firms established internal capacities for research and development (Frieden 2006: 165). These assets are firm-specific inasmuch as firms develop the assets for their exclusive use. The growing market for consumer products also raised returns on investments in product advertising. During the interwar period, European consumer products firms marketed directly to U.S. consumers. Switzerland's Nestle sold chocolate, and Britain's Lever Brothers Company became the leading soap manufacturer in the United States (Jones 2005).

FDI for the production of goods and services grew more popular during this period, because it allowed firms to exploit the scale economies that their intellectual property assets create. Firms can deploy these assets in multiple markets simultaneously, because they are intangible, allowing them to recoup more readily the initial fixed costs of creating the asset. As Chapter 2 explains in detail, firms choose FDI over alternative routes for capturing scale economies, like technology licensing, because in FDI firms retain control over their most valuable assets.

Firms organize their multinational production that uses these assets in one of two ways. Beginning in the interwar period, most MNCs organized their multinational production by replicating production and sales activities in multiple countries. This allowed them to circumvent the rising trade

[2] Svedberg (1978) argues that this common figure is an underestimate because it is inferred from public stock offerings (countries did not systematically collect and report data on capital flows in this era). By his calculations, FDI accounted for a large portion of capital flows into specific economies, including up to 50% of total capital inflows for countries/colonies in Asia, Africa, and Latin America. In many respects royally chartered trading companies such as the British East India Company were predecessors of the modern MNC.

[3] In the United States, specific FDI projects were occasionally controversial but there was little formal regulation. The federal government and several states passed laws barring foreigners from purchasing land and owning banks. A handful of additional regulations discriminated against foreign-owned firms. For instance, a 1791 federal law charged foreign ships higher customs duties and an 1817 law closed coastal trade routes to foreign merchants (Wilkins 1989).

barriers in this era and to compete for foreign customers in non-traded industries. In the decades following World War II, a growing number of MNCs pursued FDI to forge a global production networks that fragment production of a single product across multiple countries. By organizing production in this manner MNCs take advantage of lower production costs in foreign countries and export their output out of the host country. Global production networks became more efficient as transportation costs and host country trade barriers declined.

The iconic American toy, the Barbie doll, vividly illustrates this larger phenomenon of globalized production.[4] Barbie's "Made in China" label belies the toy's multinational origins. In 1996, the southern California-based Mattel Corporation sold "My First Tea Party Barbie" in the United States at a retail price of $9.99 per doll. Of this, $7.99 went directly to Mattel as profit and to defray the costs of domestic distribution and marketing. Sixty-five cents was paid for the raw materials and their processing: Saudi Arabian ethylene, a by-product of oil refining, and Taiwanese refining to convert the Saudi ethylene into the plastic pellets used in manufacturing the doll's body; Chinese cloth for the doll's clothing; nylon doll hair from Japan; and American machinery, molds, and paints. Thirty-five cents contributed to the wages of the 11,000 workers who assembled these components in two factories in Guangdong, China. The remaining $1 of the doll's purchase price went toward the transport of production inputs and finished dolls between the raw materials source countries, the Guangdong factories, and the United States, the doll's ultimate consumer market. Hong Kong acted as the hub of the production network. Inputs and final products were transported over land between Hong Kong and Guangdong and by sea between Hong Kong and all points abroad.

FDI first became politicized during the interwar period. Controversy centered on the perceived national security costs to the foreign ownership of productive assets, but limits on foreign ownership simultaneously advanced the interests of local producers vis-à-vis foreign MNCs. For example, when during World War I the U.S. government seized all enemy combatants' assets, among them were some 6,000 chemicals and pharmaceuticals patents owned by U.S. subsidiaries of German companies. At the time Germany was the world's leading producer of industrial chemicals and pharmaceuticals. While the United States justified the seizure on national security grounds, it also proved lucrative for U.S. chemicals producers. The federal government licensed the German patents to U.S. companies at

[4] "Barbie in the World Economy," *Los Angeles Times*, September 22, 1996.

minimal costs, and the previously lagging U.S. chemicals industry flourished (Wilkins 2004). These countries' situations were reversed after World War II when Western European countries voiced concerns about the dominance of U.S. corporations over the Continent's industrial production. The noted French intellectual Jean-Jacques Servan-Schreiber articulated these anxieties in his 1967 Europe-wide bestseller, *The American Challenge*:

> The Common Market has become a New Far West for American businessmen. Their investments do not so much involve a transfer of capital, as an actual seizure of power within the European economy. Statistics fail to reflect the real gravity of the problem. … [T]he Common Market has become the New Frontier of American industry, its promised land. … If Europe continues to lag behind in electronics she could cease to be included among the advanced areas of civilization within a single generation. (Servan-Schreiber 1967: 11–14)

These examples demonstrate that even though politicians frame FDI inflows as a threat to national security or other vital national interests, there are also unmistakable distributive consequences to foreign ownership. U.S. subsidiaries of German chemicals companies dominated their American counterparts, but policy interventions transferred channeled German comparative advantage to U.S. firms. To be sure, there are genuine national interest reasons to regulate FDI, but to end the discussion at that would be to overlook these policies' clear distributive consequences.

My analysis of FDI regulation begins in the 1970s, the era of wide-scale adoption of foreign ownership restrictions as elements of broader industrialization strategies.[5] Although national security justifications first appeared following World War I, more explicitly economic motives for FDI restrictions first emerged following World War II. Decolonization in Asia and Africa produced an influx of new independent countries in the global economy. These countries, whose economies were previously centered around agriculture and mining, adopted comprehensive industrialization strategies

[5] A few industrialized countries including Japan, Australia, and Canada also frequently restricted FDI inflows (Chang 2003). The prevalence of state-owned enterprises and public ownership shares in private corporations have also been de facto barriers to investment. By law, foreign firms could not invest in sectors designated as public monopolies. MNCs often found it difficult to acquire ownership interests in firms with public participation because public shareholders could block such efforts. In Germany, tight connections between banks and industry made it difficult for MNCs to acquire local firms and to obtain local financing for investments. There is also anecdotal evidence of European countries pressuring MNCs to adopt production practices that facilitated technology transfer. For example, the United Kingdom allegedly pressured UK affiliates of Japanese electronics and automobile firms to source their inputs locally, restrict output, and export output rather than sell it domestically (Young et al. 1988).