Sole dictator-led countries make tempting target for certain investors

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Dictatorships are typically thought to be risky places for investments, but Penn State researchers indicate that the potential to monopolize markets can make up for the risks associated with investing in those regimes.

In a study, researchers found that personalist rule—a non-democratic government usually ruled by a sole dictator and a few family members—have received significantly more foreign investment in fixed-asset intensive industries than other political regimes. Fixed assets—or immobile assets, such as land, buildings, machinery and equipment—constitute a large proportion of total assets for firms in the mining and oil industries, for example.

"Conventional wisdom is that if the company has a lot of fixed assets, assets that aren't mobile, it would want to avoid risky countries, especially in personalist regimes where the power is controlled by one person, who could very easily seize your assets," said Boliang Zhu, assistant professor of political science and Asian studies. "But recently, in the past decade or two, those seizures have become rare and those acts can be constrained by international investment agreements. Our argument is that, in light of that, it's much easier now for companies to have a market monopoly in those regimes because you're only dealing with a single person."

Foreign investors can strike deals with dictators to gain market monopolies that offset the risks, added Joseph Wright, associate professor of political science, who worked with Zhu on the study.

"Places that are conventionally high risk because they don't have legislatures that check the leader's behavior and legal rules don't really apply to restrain leaders from doing ugly things, like confiscating the assets of international investors," said Wright. "Those countries also tend to be the same places where you're most likely able to get the benefits of a monopoly deal by striking a deal with the leader, or his close political allies, which sometimes include the dictator's family members."

However, deals with dictators often include illicit forms of payments, such as bribes and gifts, which can siphon off money from the public good and are hard to track.

The researchers, who report their findings in the *International Studies Quarterly*, online now, said that the dictator can use these funds to prop up the regime.

"What the dictator will do is give the contract to a firm at a below-market price because of a personal connection and that money will be added to the company's books and flow through the national treasury to look like a legitimate deal, but then, on the side, they pay the dictator in another bank account," said Wright. "And the dictators can use that money for whatever they want."

International initiatives to back transparency may be one way to address the issue of illicit investments in personalist dictatorships. The researchers said that one example of a global transparency program is the Extractive Industries Transparency Initiative, which seeks to establish a global standard for promoting open and accountable management among companies that extract natural resources.

Western countries could also better manage the financial systems by which the process operates.

"It has to be a global movement because it requires global coordination," said Zhu.

Because much of the financial dealings in personalist dictatorships are not readily available, the researchers used data from 61 countries included in a dataset provide by the United Nations Conference on Trade and Development to compare data on foreign direct investments in the various economic sectors of personalist dictatorships with similar types of investments in the economic sectors of other types of regimes. According to the researchers, investments in personalist regimes tend to be higher in primary sectors, which includes natural-resource extraction and agricultural industries, compared with other types of dictatorships, such as single-party ruled regimes.

To determine whether the government was a personalist dictatorship, the researchers used a personalism indicator established in a prior study. The indicator helps determine whether the leader has consolidated power at the expense of a political party, military, or another internal security group.

The researchers said the pattern of foreign direct investments is in line with their argument that personalist regimes have higher foreign investments in natural-resource extraction sectors.

More information: Joseph Wright et al, Monopoly Rents and Foreign Direct Investment in Fixed Assets, *International Studies Quarterly* (2018). DOI: 10.1093/isq/sqy010

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