Institutions, Volatility and Investment
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Discussion by
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The views expressed here are those of the presenter and not necessarily of the Federal Reserve System.

Summary

- Part 1: Empirical investigation
  - FDI flows from Netherlands to 156 countries.
  - Executive constraint
    - Policy uncertainty: Julio and Yook (2012,2016), Baker, Bloom, and Davis (forthcoming).
  - Strong executive constraints associated with more FDI flows.
- Part 2: Build a theoretical model to explore a mechanism.
  - Higher executive constraints

    $\Longrightarrow$ Lower variance of productivity growth

    $\Longrightarrow$ Higher investment

Positioning of the paper

International or macro?

- Elements of international economics:
  - Motivate using Rodrik (1991): FDI investment and policy reversibility
  - Use FDI flow data
- Missing FDI Elements?
  - Foreign investment:
    - Additional layers of rules and regulations associated with national boundaries.
    - More sensitive to political environment than domestic investment (Dixit (2011)).
  - The model: "if we had good country level or sector specific data on firms, this too could be used"

Underlying Assumption

The paper treats executive constraints as the "core measure of political institutions."

- Shows executive constraints affect FDI flows more than other democracy components.
  - Other democracy measures: openness of executive recruitment, competitiveness of executive recruitment
- States the correlation doesn't seem to stem from the fact that executive constraints proxy for other political institutions/economic factors.
  - Other democracy measures, GDP per capita, GDP per capita growth, schooling, fixed effects.

Executive Constraints and Political Institutions

- Political institution measures?
- ICRG political risk rating components:

POLITICAL RISK COMPONENTS		
Sequence	**Component**	**Points *(max.)***
* A	Government Stability	12
* B	Socioeconomic Conditions	12
* C	Investment Profile	12
* D	Internal Conflict	12
* E	External Conflict	12
F	Corruption	6
G	Military in Politics	6
H	Religious Tensions	6
I	Law and Order	6
J	Ethnic Tensions	6
K	Democratic Accountability	6
L	Bureaucracy Quality	4
Total		100

Executive Constraints and Political Institutions–cont'd

- Foreign investment literature has examined various components of quality of political institutions.
  - Wei (2000): corruption
  - Daude and Fratzscher (2008): expropriation risk, property rights
  - Gelos and Wei (2005): government transparency
  - Daude and Stein (2007): regulatory quality, control of corruption, rule of law, etc.
  - Julio and Yook (2016): political uncertainty, government stability, checks and balances, etc.

Executive Constraints and Political Institutions–cont'd

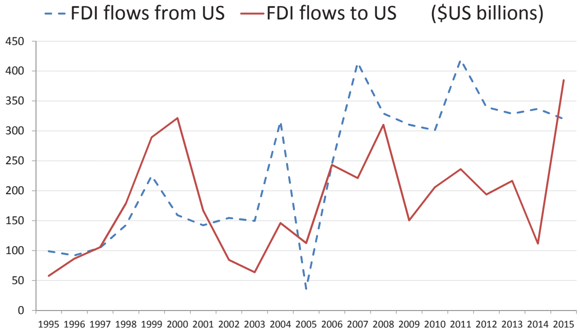
- Adoption of strong executive constraints: exogenous?
- Is this a better political institution measure than others?
  - Correlated with other measures?

	Correlation Coefficients		
	Checks and Balances	Control of Corruption	Government Stability
Executive Constraints	0.27	0.28	-0.18

  - Checks: The number of veto players in a political system (World Bank Database of Political Institutions).
  - Government stability: governments ability to carry out its declared programs, and its ability to stay in office (ICRG).

Executive Constraints and Political Institutions–cont'd

- Time-series variation?



*Source: Financial Accounts of the United States, Federal Reserve Board

Empirical Specification

Pseudo Poisson regression

- From the trade literature.
- Outcome variables cannot be negative.
  - Mostly use "gross" FDI flow data
  - Robustness check using net flows: they set negative flows to zero.

- FDI measure: flows to a country relative to those to all countries.
  - flows/populatoin, flows/GDP, flows(t)/FDI stock(t-1)

Empirical Specification–cont'd

Statement that the correlation doesn't seem to stem from the fact that executive constraints proxy for other political institutions/economic factors:

- The paper controls for log(GDP per capita), GDP per capita growth, and years of schooling.
- Other standard time-varying FDI controls:
  - Trade openness
  - Changes in exchange rate and volatility.
  - Stock market return, return volatility

To Wrap Up...

- I really enjoyed reading the paper.
- Interesting new approach.
- Intuitive model explaining the mechanism.
- Would benefit from better motivation and positioning.