Foreign firms face the risk of harmful treatment by host governments, which can deter investment. To mitigate this risk, states create and join international institutions to generate substantive commitments and signal good intentions. As these institutions have grown in number so too has FDI, yet there is no consensus on whether or how these two trends are related. We argue that the extent to which membership in international institutions reassures investors depends on the investment profile of the other members within these institutions. For membership to boost investor confidence, institutions must maintain a generally positive investment profile. Institutions comprised of states with high investment risk do little to ease investors’ concerns. Moreover, the degree to which an institution’s perceived risk profile reassures investors depends on the capacity to adjudicate the enforcement of standards, which varies tremendously across organizations. To evaluate the empirical implications of our argument, we employ data on state participation in international organizations, alongside flows of FDI, over the 1985-2013 period. We demonstrate that the effects of international cooperation on FDI depend crucially on both who is cooperating and the design of the organization.

*Emilie M. Hafner-Burton (corresponding author; ehafner@ucsd.edu) is the John D. and Catherine T. MacArthur Professor of International Justice and Human Rights at the School of Global Policy and Strategy and the Department of Political Science at the University of California, San Diego, and director of the Laboratory on International Law and Regulation. Heidi M. McNamara (corresponding author; hmnamara@ucsd.edu) is a doctoral candidate in the Department of Political Science at the University of California, San Diego. Christina J. Schneider (corresponding author; cjschneider@ucsd.edu) is Associate Professor and Jean Monnet Chair at the Department of Political Science at the University of California, San Diego, and Jean Monnet Chair. Schneider gratefully acknowledges financial support from the UCSD Academic Senate (#RP85G-SCHNEIDER). We thank Rachel Schoner for her research assistance, and Stephan Haggard and Inbok Rhee for detailed comments. This paper has been presented at the International Political Science Association Annual Meeting, Brisbane Australia, 23 July, 2018 and the American Political Science Association Annual Meeting, Boston MA, 30 August, 2018.
Foreign direct investment (FDI) is widely seen as an engine for economic growth, especially in the developing world. Yet, foreign firms face risks of harmful treatment by host governments, which can deter investment. In an effort to mitigate these risks, states create international investment institutions, such as bilateral investment treaties (BITs) and other treaties with investment provisions (TIPs), to reduce potential investor uncertainty by generating substantive commitments and signaling good intentions. As these institutions have grown in number—there are thousands now in force—so too has FDI, which currently amounts to almost two trillion USD in global flows.

There is no consensus on whether or how these two trends are related. While some studies provide evidence that these agreements foster investment, others provide evidence to the contrary, or suggest that any link is endogenous because states on an upward FDI trajectory are more likely to enter these institutions in the first place. Moreover, there is no agreement as to how these institutions might generate investment—if they do—or what role the design of agreements plays, if any, in fostering a link. Some studies suggest that agreements must provide dispute settlement or third-party adjudication to reduce a country’s risk rating and generate investment, while others find that even agreements that provide such guarantees have no apparent investment-enhancing effect.

This article makes several contributions to this debate about the role of international institutions in the promotion of FDI. First, we argue that the extent to which membership in international institutions provides investors with additional information about a state’s commitment to protect property rights—over and above a state’s own risk rating—depends on the investment profile of the other states within these institutions. In high-uncertainty environments, investors take cues from the states that a potential host country routinely cooperates with. Those cues inform important decisions such as whether to service a country’s debt. Here, we argue that those cues also provide information about potential commitment problems. When institutions are comprised of states that maintain a positive investment profile—defined as low risk environments for contract viability or expropriation, profits repatriation, and payment delays—they provide investors with some additional reassurance that a member state’s substantive commitment to investor-friendly policies is credible, thereby reducing the uncertainty that might otherwise deter FDI to that state. By contrast, membership in institutions comprised of states with high perceived risk does little extra to ease investor concern over the integrity of their ventures because these institutions do not deter their members from engaging in high-risk behavior.

Second, the degree to which an institution’s perceived risk profile reassures investors depends on the costliness of the commitments made, specifically on the institution’s capacity to adjudicate the enforcement of standards. That capacity varies tremendously across organizations. Membership in investor-friendly institutions that offer binding adjudication, with a remedy for

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non-compliance—such as retaliatory sanctions—or where court rulings have direct legal effect, is much more likely to boost investor confidence, assuring that disputes are handled efficiently, and thus creating a more predictable environment for investors. Not all investor-friendly institutions, however, provide these formal means. Those institutions without dispute settlement, or where settlement is not obligatory, do measurably less to reduce uncertainty over investor risk.

Third, the centrality of membership characteristics and design features suggests that it is not only BITs and TIPs that can stimulate FDI—the institutions that have been the primary focus of research—but also membership in a much broader collection of economic and political organizations. Investors seek assurances that a potential host government will not renege on its commitments to respect property rights. Protecting property rights requires that a government not only refrain from market-specific interventions that negatively impact investors, but also commit to the operation of a functioning political system to make and enforce the rules to protect those rights. While international trade and investment agreements may help to shore up investment promises, so too may participation in a much broader range of international organizations (IOs) that generate substantive commitments to the protection of property rights, a liberal market economy, and the rule of law.

To evaluate the empirical implications of our argument, we employ data on FDI inflows to 128 countries, together with their membership in 426 international organizations, over the 1985-2013 period for which we have data. We examine the relationship between a potential host country’s exposure to IOs with various investment risk profiles and dispute settlement features, and their future levels of FDI (change over time). Our analysis, which contributes to the growing literature on international institutions and foreign direct investment, provides support for our argument and thereby integrates two strands of literatures previously examined in isolation. The effects of international cooperation on FDI depend crucially on both who is cooperating and the design of the organization. While IOs can help to mitigate the credible commitment problems that deter investors in some circumstances, their makeup and rules determine that capacity.

THE (WELL UNDERSTOOD) CREDIBILITY PROBLEM OF FOREIGN DIRECT INVESTMENT

Inward flows of FDI are widely seen as beneficial. Given the right conditions, investment creates jobs, builds capital, and transfers modern technology and knowledge that can help a developing country integrate into the global economy and raise income. It can also bring more environmentally and socially responsible business practices. Yet, investment is a risk. At the core of any investment process are property rights: “. . . the rights individuals appropriate over their own labor and the goods and services they possess.” They are intended to constrain the appropriation of these factors, or the ability of one actor to usurp another’s control over their own labor, goods and services.

In the investment context, the protection of such rights is essential to ensure that a host government, or other domestic actors such as competitors, does not hinder the value or functioning

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4 Hafner-Burton et al. 2016.
5 Although we look at a much broader sample of organizations, this argument is consistent with Dreher and Voigt 2011, who examine the relationship between a handful of international organizations and country risk ratings.
7 North 1990, 33.
of the investment. This includes actions, such as taking whole or part of an investment over, as well as interference with aspects necessary to ensure the integrity of the venture—that might include manipulating the cost of or access to raw material inputs as well as intangible things like intellectual property rights. For an investment to be made, the investor and host government must have reached an agreement that initially favored the venture. As the investor sinks more assets into the host country, however, the bargaining power shifts to the host government and, in the extreme, turns fixed assets into liabilities—this generates an obsolescing bargain. In industries marked by long-term investments that sink capital, there are particular incentives for host countries to adopt policies, like requirements for new royalty payments once a mine comes into operation, that are tantamount to expropriation.

To attract and preserve investment, host governments need to make credible commitments to provide—and stick to—investor-friendly policies that protect their property rights. But these commitments often occur in the shadow of significant uncertainty. Host governments know at the time they make these commitments that situations may arise that create incentives for them to renge on their promises. Some may simply be unable to follow through on their promises for unforeseen reasons. And many do not have the local judicial or political capacity or will to enforce a promise to protect property rights in the face of such uncertainty or pushback. One way that host governments can make their promises appear more credible is by joining IOs that act as a substitute for a poor, or uncertain, domestic reputation or political processes. Membership in certain IOs can generate more credible information about a state’s investment risk propensity, over and above the state’s own track record and perceived level of risk.

**HOW (SOME) INTERNATIONAL ORGANIZATIONS CAN LESSEN THE CREDIBILITY PROBLEM**

While the existing literature has focused almost exclusively on the role of BITs—and to a lesser extent, trade agreements—in muting the credibility problem that can deter investment, we argue that membership in economic and political organizations more broadly can provide similar or complementary functions. In order to stimulate investment, membership in an IO must appear to shape a country’s current and future calculations, such that honoring promised commitments to protect an investor’s property rights remain worth honoring, and that the associated costs of breaking those commitments are high. In theory, membership in BITs and TIPs may help do so by increasing market size, making public promises to market friendly policies, or providing dispute settlement over specific disagreements. The institutionalization of such commitments provides information about who is—and who is not—following the rules and generates reputational risks for those who violate them.

**A General Phenomenon**

Our argument reveals that membership in a much wider range of political and economic IOs provides many of the same—and potentially some additional—functions as BITs and TIPs. IOs seek to spread norms of behavior that improve the quality of cooperation and the size of benefits

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8 Salacuse 2013.
9 Vernon 1971.
11 Büthe and Milner 2008; Dreher et al. 2015.
states reap from membership. One way they do so is by providing substantive information about the expectations for member behavior, establishing rules and standards such as those stated by the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The OECD is not an investment agreement—the organization’s core mission is to promote policies that will improve the economic and social well-being of people around the world. Yet, the core premise of this convention relates directly to the concerns of potential investors. It seeks to establish a system of commitments on behalf of governments to guard against bribery in international business transactions, which can distort international competitive conditions and discourage investment. Today, the Convention’s Working Group is charged with the task of carrying out monitoring and evaluation to promote implementation of the law in cooperation with the OECD Investment Committee (among others).12 That committee promotes the liberalization of policies to facilitate international capital movements and FDI, provides a forum for discussion, and monitors and reports on government efforts to provide an open and transparent environment for international investment. Despite the fact that the OECD is not an investment organization per se, membership provides information about a state’s intended commitment to uphold investor-friendly policies.

Another example is the European Union (EU). The EU is now both the largest provider of, and destination for, FDI in the world. Yet, despite its competencies in FDI policies and regulations, the EU’s mandate extends far beyond investment. The EU has established an *acquis communautaire* that lays out precise expectations for membership. Among those expectations are specific requirements regarding the free movement of goods, workers and capital across borders, as well as a range of standards covering everything from agriculture and rural development to energy, taxation, and social policy. In principle, all EU member states and their citizens are required to conform to the common *acquis* and all countries seeking membership in the EU must accept the full set of standards, which includes a wide range of markers for good governance.13 The EU’s investment-related objectives include opening up foreign markets for European companies, maintaining clear and consistent international investment rules, protecting the investments of EU citizens and companies abroad and ensuring the free movement of payments, capital and personnel necessary for investment.14 Recently, the organization proposed a regulation to help the EU and the member countries review inward FDI and to protect critical European assets against investment that would be detrimental to legitimate interests of the Union or its Member States.15 While the stated goals of the EU are much broader than regulating investment—to promote peace, freedom, security and justice; sustainable development; anti-discrimination; scientific and technology progress; etc.—membership in the organization provides information to investors about a state’s intended commitment to uphold property rights.

That broad scale economic organizations—oftentimes without specific investment mandates—may generate substantive commitments that influence investor perceptions of risk should not be that surprising. After all, many of these IOs embody features and commitments to sustainable liberal market policies that are similar to—and some vastly more expansive than—those found in BITs and TIPs. However, appropriation and other investment-degrading practices are as much political risks as they are economic ones. Protecting property rights requires not just commitment to investor-friendly policies on paper, but also host government capacity and willingness to

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demonstrate a commitment to political stability, control over domestic actors that would otherwise seek to interfere with an investor, and a regulatory framework to instill those rights. Political IOs can help establish these complementary commitments in various ways.

The Pacific Island Forum (PIF), for example, seeks to stimulate economic growth through improved political governance. Their mission states that members seek to facilitate gender equality, respect for human rights, sustainable management of the region’s resources, observance of democratic values, and more.16 As a part of this effort, the organization coordinates economic planning meetings for its members. They host an annual Forum for Economic Ministers Meeting, which stresses the importance of good governance—broadly defined—for economic growth.17 The decision to join the PIF suggests that a state is willing to commit, at least on paper, to the organization’s communal ideals. By linking respect for human rights—including recognition of property rights—and sustainable resource management to economic growth, the PIF serves as an example of how an IO’s commitment to the broader ideals of stable governance can in principle signal to potential investors the stability of member states’ investment environments.

The North Atlantic Treaty Organization (NATO) is another example. NATO is a political and military alliance that promotes democratic ideals in the pursuit of trust building among member states and conflict prevention. In order to accede to NATO, states are expected to meet certain political, economic, and military benchmarks. By meeting these standards members make a stated commitment to the organization’s mission, which can impact perceptions of risk. In their assessment of NATO’s history and future, Todd Sandler and Keith Hartley argue that if prospective NATO allies can achieve political stability, “then foreign direct investments, an important source of savings and growth, will be attracted to them, which in turn will bolster their economic prosperity and stability”.18 Indeed, a side benefit of NATO membership, which flows from its security and political benefits, has been increased economic activity in new member states.19 That is consistent with current speculation that Montenegro’s recent accession to NATO will send a strong signal to global and regional financial markets, boosting investment and growth.20 The benefits of mutual defense that NATO provides, particularly for smaller states, incentivize members to remain in good standing and maintain economic stability and growth. Though NATO is by no means an economic organization, the stringent accession process, which requires prospective members to stabilize their economies and guarantee protections relevant to investors, sends a signal that any state approved as a member of NATO is likely a safer bet for investment.21

18 Sandler and Hartley 1999, 69.
19 https://www.rferl.org/a/1099664.html.
21 This argument is consistent with Dreher and Voigt (2011), who argue that ratification of UN human rights treaties—quite obviously not investment agreements—can reduce a country’s risk rating. Specifically, they claim that participation in the International Covenant on Economic, Social and Cultural Rights and the International Covenant on Civil and Political Rights, as well as the Optional Protocol aiming at the abolition of the death penalty and the Convention Against Torture, can affect how investors perceive a country’s risk of abrogating commitments to uphold property rights. They signal a country’s commitment to upholding human security, which is an essential condition for the protection of property rights.
A Conditional Effect

Thus far we have argued that participation in a broad array of IOs can provide information to potential investors about a state’s level of commitment to free market ideals and the economic and political stability necessary to protect an investment, above and beyond a state’s own level of perceived risk. However, when it comes to their ability to signify actual member credibility to follow the rules, not all organizations are created equal. The degree of additional investment credibility states garner, if any, from IO membership depends on two key features of the organization that shape how investors will react. The first feature concerns the perceived investment risk profiles of the other members. For membership to boost investors’ conviction that a potential host state is a good candidate, that state must work with other states that are also perceived to be trustworthy. The financial and political credibility of a state’s co-members in an IO informs potential investors about the expectations of membership in that organization.22

No matter the substantive commitments made on paper, not all organizations generate equally meaningful signs of constraint on their members. Sometimes, talk is cheap. A host country’s membership in IOs composed of states with histories of expropriation does little to demonstrate a commitment to investor-friendly policies, nor does it indicate any institutional pull toward mitigating such risk. If other member states in an organization routinely breach property rights, and investments are, in turn, wrongfully harmed, the organization clearly is not reigning in its membership. Being a member thus adds little by way of additional substantive constraint on, or positive signal about, a country’s policies and preferences toward investors, and therefore does not help to generate FDI from skittish investors.

Consider, for example, the small state of Suriname, which joined the Caribbean Community (CARICOM) in 1995. CARICOM on paper aims to deepen integration among its twenty member states, stretching from the Bahamas to Guyana. Among the organization’s formal goals are to facilitate social cohesion, ensure good governance, reduce poverty, and increase investment.23 Yet by joining CARICOM, Suriname formally surrounded itself by countries such as Haiti, which pose extremely high risks for foreign investors relating to taxation, operations and repatriation restrictions and labor costs.24 Despite the organization’s stated aspiration to attract FDI among members, the low quality risk rating among its membership did nothing to convince investors that Suriname, by joining, would become a safer bet for investment. FDI inflows as a percentage of the country’s GDP have remained mainly in the negative; more than a decade after accession, FDI reached an all-time low.25

Consider, also, Gabon, which joined the Economic Community of Central African States (ECCAS) in 1989. Despite the fact that the ECCAS was specifically formed to promote cooperation and economic development,26 Gabon’s accession to the organization has not reassured potential investors. Gabon’s co-member states in ECCAS have abysmal investment profiles. Cooperation with these states, even when this cooperation is purportedly directed toward economic

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23 https://caricom.org/.
development, has not made Gabon a more credible host. Instead, FDI inflows declined from two to three percent of GDP in the years prior to joining the organization to negative or almost zero percent in the years following accession. While we cannot claim a causal effect, clearly, membership in this organization has not led to a growth in FDI.

Where co-member states participate in risky market behavior, IO member states are not reliably held accountable to safe market practices and participation in IOs does little to boost potential investor confidence. Other organizations, however, generate a more positive signal about their members’ likely propensity to protect the rights of potential investors. When a state belongs to an IO whose general membership demonstrates a stronger track record that favors investment, their pledge to protect property rights is seen by investors as holding more weight. By joining an IO with other “investment-friendly” members, a state publicly commits to providing the same goods. They trade at least some of their sovereign ability to breach foreign investors’ property rights in order to access the benefits of IO membership—including, we argue, increased FDI.

One example is Mexico’s 1994 accession to the OECD—an organization made up of now-34 countries with strong to stellar investment profiles—alongside its adoption of NAFTA. NAFTA, of course, is (was) a trade agreement with an explicit set of provisions (stipulated in Chapter 11) relating to investment, services and related matters with Canada and the United States, including provisions for investor-state arbitration. As explained above, while not a trade or investment agreement, the core provisions of the OECD also relate directly to the concerns of potential investors and security of property rights.

There is widespread agreement that NAFTA has helped boost investment, in at least some sectors, to Mexico. There is also evidence to suggest that OECD membership has had a similar effect and at greater magnitude. Accession to the organization led the Mexican government to undertake a variety of investment enhancing reforms in an effort to put the country on the playing field with one of the world’s most exclusive clubs. During the uncertain period leading up to the signing of NAFTA, Mexico purportedly saw its bid for OECD membership as a potential alternative to lock in market friendly reforms in the event that NAFTA failed, and also as a mechanism to credibly signal that Mexico was ready to seek a more “active world role”.

Becoming a member was a complex process of accession that required substantial liberalization of markets through the adoption of new legislation to open the country to FDI—without restrictions—to all other countries, and a new law to provide foreign issuers access to the domestic stock market.

Though the OECD is not an investment agreement, accession clearly played a role in Mexico’s liberalization that went well beyond their NAFTA commitments. Prior to membership in both of these organizations, Mexico’s FDI inflows as a percentage of its GDP was small (merely 0.87%). Upon joining, however, investment increased substantially and has since continued to rise, and not simply under the auspices of NAFTA. By 2013, Mexico had almost quadrupled its FDI inflows to over 3.3 percent of its GDP. Today, the top sources of inflows behind the US include FDI from Spain, the Netherlands, and Belgium, all members of the OECD. While these illustrations are anecdotal—and factors other than OECD and NAFTA membership are surely affecting investor decisions—they are consistent with the idea that states making commitments to institutions

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29 Davis 2016.
30 In our sample, the average FDI inflow is 1.5% of GDP with a maximum of 27%.
characterized by investor friendly members are more likely to attract new investment. Membership in these organizations almost certainly helped to dampen investor concerns about Mexico’s credibility and boost FDI.

The information that investors garner from a state’s membership in an IO therefore varies based on who a state collaborates with through that organization.

Hypothesis 1: A state is more likely to receive more foreign direct investment when its IO co-members have low risk investment profiles than when it cooperates with high risk states.

Who states collaborate with provides useful information to potential investors about a state’s commitment to mitigate risk, but it is a second feature of the organization that determines how credible those commitments are: the ability to adjudicate and enforce. IOs vary widely in their ability to enforce the commitments members make. These different levels of institutionalization require states to cede varying amounts of sovereignty in exchange for membership. The more enforcement capability states lend to an organization, the more credible their commitment to the tenets of the IO—and the membership—by participating.

Just as joining an organization made up of high-risk members will not add much additional reassurance to investors no matter the rhetoric of the organization, joining an IO that has no formal ability to hold its members accountable might still help, but it will do less to formally tie the hands of a member state or convince investors that the government will suffer recrimination if it does not uphold its promises. By contrast, the message states send to potential investors by cooperating with other investor-friendly states, such as the members of the OECD, is further bolstered by joining organizations with enforcement mechanisms, such as formalized dispute settlement and adjudication.

IOs’ dispute settlement strategies take many forms and give organizations varying levels of enforcement capacity over their members. At a basic level, IOs vary in whether or not their dispute settlement mechanisms are obligatory or whether their member states can choose to opt out. For example, dispute settlement decisions made by the Council of the League of Arab States are only binding on member states that choose to vote, allowing states to opt out of policies they disagree with without penalty. Membership thus does little extra to assuage investors. By contrast, all member states of the World Trade Organization (WTO) are subject to the decisions of the organization’s Dispute Settlement Body and cannot opt out, which by many accounts helps to explain why countries such as Vietnam that have recently joined the organization have seen a sharp increase in investment, from an inflow of nearly $12 billion at accession to more than $70 billion two years later.32

IOs’ dispute settlement processes also vary in whether or not their decisions are binding on members. For instance, disputes settled by the Bank for International Settlements (BIS)—owned by 60 central banks representing 95 percent of world GDP—are obligatory and binding, though rely on members’ central banks to uphold their rulings and appropriately penalize their domestic banks for any misconduct. Anecdotal evidence shows a substantial increase in FDI among members such as India, Indonesia and Israel directly upon joining.33

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33 India joined in 1996 and saw an immediate uptick in FDI as a percentage of GDP, from .58 in 1995 to .85 in 1997, steadily rising; Indonesia joined in 2004 and jumped from -.25 in 2003 to 2.92 in 2005.
Finally, dispute settlement mechanisms vary also in who the organization allows standing for filing complaints. Some organizations, such as the European Free Trade Association, only allow member states to bring forward complaints. Others, such as the Southern African Development Community, allow non-state actors to lodge complaints directly. Standing is potentially important because it opens up the playing field for non-state actors, such as investors, to bring complaints against member states directly to the organization for review and adjudication. This raises the prospects that a member state in violation of an investor’s venture will be held institutionally accountable for expropriation or other wrongful harms.

Joining an IO where the dispute settlement body has the ability to enforce their rulings requires states to cede higher levels of sovereignty to the organization and sends a stronger signal that their commitment to the standards of the organization and its membership is credible. This combination of factors—a generally low risk membership coupled with enforcement procedures—should most help reassure foreign investors. EU Eastern enlargements serve as an example. In 2004 and 2007, twelve Central and Eastern European countries acceded to the EU, most of them with very low FDI inflows and high-risk investment profiles. Bulgaria and Romania, two latecomers, entered the EU with investment profiles that were below the world average, and significantly below the investment profiles of the Western European member states. Despite their weak domestic institutional and regulatory environments, both countries experienced significant increases of FDI inflows after their accession date was finalized in 2003. Romania more than quintupled its inflows from 1.4 percent of GDP in 2002 to over 10 percent in 2006. Bulgaria’s FDI inflows grew from 3.7 percent in 2002 to over 25 percent in 2006.

These rises are generally attributed to their accession to the EU, which fostered incentives to make regulatory reforms that would reassure investors. EU membership was conditional on reforms establishing sound private governance supported by effective judicial and administrative institutions, which itself served as a way to generate and attract investments needed for vigorous economic growth. It was not only the enforcement through the accession conditions that contributed to greater FDI into Eastern European states, but also the ability of the EU to enable, encourage and protect investments in its members. Investors benefit from the Single Market’s fundamental freedoms: they enjoy the freedom to establish a business, to invest in companies and to provide services across borders. Investors can also rely on fundamental rights such as the right to property, access to justice, non-discrimination, the principle of proportionality, legal certainty and the protection of legitimate expectations. Investors are also protected through a large body of sector-specific legislation covering areas such as financial services, transport, energy, telecommunications, public procurement, professional qualifications, and intellectual property or company law. The European Court of Justice (ECJ) and national courts enforce these rights through preliminary rulings or infringement proceedings.

The Common Market of the South (MERCOSUR) serves as another example. Initiated in 1991, the goal of MERCOSUR was to create a free trade area amongst its members and, later, a common external tariff and common market. Along with signing the Treaty of Asunción, original member states underwent significant, though quite variable, domestic economic policy reform,
many turning away from import substitution toward free market policies.\textsuperscript{38} By many accounts, the regional uptick in FDI (and trade) in the 1990s in countries such as Brazil was associated in part with the trade liberalization process propelled by MERCOSUR, an institution with a relatively strong average member investment profile.\textsuperscript{39} Although MERCOSUR has always had formal dispute resolution provisions, the economic and financial crises in the early 2000s generated incentives to bolster the institution’s enforcement mechanisms. That system, created under the Protocol of Olivos, forecloses forum shopping, allows for judicial review and specifies retaliatory measures. According to Arnold and Rittberger, the driver behind these reforms, institutionalized as capital began to flee the region in crisis, was “to send a costly and credible signal to potential traders and investors that MERCOSUR integration – and hence measures facilitating transnational exchange – would prevail over protectionist policies.”\textsuperscript{40} MERCOSUR’s updated dispute resolution system has since played an important role in encouraging investment in countries such as Brazil,\textsuperscript{41} though a host of other factors explains why some MERCOSUR countries have underperformed their peers in the ability to attract FDI\textsuperscript{42}

There is ample (anecdotal) evidence that these relationships between IO membership and investor perceptions of risk—and thus willingness to invest—are not just spurious. Investors actually take risk cues from organizational memberships, in part because organizations can and at times do intervene. A good example concerns the Bolivía-Brazil natural gas pipeline, designed in the 1990s to transport massive quantities of gas between the two countries, promising benefits to both sides—a market for Bolivia and a supply for Brazil. Yet the state-owned monopolies on both sides of the deal were unable to fund the project, which required considerable investment and infrastructure upfront, while private partners expressed concerns over the perceived regulatory and supply risks associated with operating in both countries. Ultimately, it was membership in—and the conditional pledge of support from—the World Bank and other multilaterals such as the Inter-American Development Bank which assuaged investors—including Enron, British Gas and Shell—to form private joint ventures with cross-border ownership that would bring the pipeline to fruition. The enforceable policies created by the leading donors in these institutions would encourage both countries to undergo substantial reform of their hydrocarbon sector to open the market to competition and private participation by foreign investors.\textsuperscript{43}

Of course, IOs mix and match these enforcement characteristics. Some, such as the Pacific Island Forum, have dispute settlement mechanisms that are binding but are not obligatory and do not allow non-state actors standing. Others, such as the East African Community are obligatory, binding, have an enforcement mechanism, and allow non-state actors standing. Still others, such as the International Labour Organization, are obligatory but do not always make binding decisions, have an enforcement mechanism, or allow non-state actors standing. This wide variation suggests that the signal sent to potential investors by the quality of membership likely differs depending on the institutional capacity of the organization to make rulings and enforce policy.

Hypothesis 2: Membership in IOs with low risk investment profiles is more likely to lead to an increase in FDI when those organizations have dispute settlement characteristics.

\textsuperscript{39} Castilho and Zignago 2005.
\textsuperscript{40} Arnold and Rittberger 2013, 99.
\textsuperscript{41} Bittencourt et al 2006.
\textsuperscript{42} Paiva and Cortes 2014.
\textsuperscript{43} Law and de Franco 1998.
To summarize, we expect that a country’s engagement in a broad swath of political and economic IOs characterized by low-risk membership investment profiles increases the likelihood that it experiences an increase in FDI. This effect should be more pronounced for states participating in organizations with low-risk membership that also have formal adjudication and/or enforcement mechanisms.

**Research Design**

Our data set builds on the Correlates of War IGO Data Set Version 3.0 and covers data on the membership of over 128 countries in 426 active international organizations for the 1985-2013 period. We measure our main dependent variable, *FDI inflow (% GDP)*, as the annual amount of FDI a country receives as a percentage of that country’s GDP. Data are from the World Bank.

Our main explanatory variable is the average IO investment profile of a country in a network of IOs. To calculate *Average IO Investment Profile*, we proceed in two steps:

1. For each IO in our sample, we calculate the average investment profile for all full member states in each year (excluding the investment profile of the country under observation). The investment profile provides information on the risk a country poses for international business, based on policy related to taxation, operations and repatriation restrictions, contract viability, expropriation, and labor costs. We use data provided by the International Country Risk Guide (ICRG). The investment profile of countries can take values between 0 and 12, where higher values indicate a lower investment risk to international businesses. We analyze the average in each organization to indicate the average credibility of members in any given international organizations.

2. For each country and year, we average the corruption score of individual IOs across all organizations in which the country is a full member.

*Average IO Investment Profile* ranges between 2.97 and 8.66 (with a mean of 5.93) and varies both across countries and over time as a function of changes in members’ investment profiles and changing membership in IOs. Figure 1 displays the distribution of these data over time for three countries, across the range of values. The Netherlands, with the highest mean *Average IO Investment Profile* in our sample, illustrates what a country looks like when they collaborate mostly with other trustworthy countries. The Ivory Coast, with the lowest mean *Average IO Investment Profile* in our sample, takes on values that are considerably lower. Panama has the average mean *Average IO Investment Profile* within our sample. While there is an overall dip in average investment profiles in the early 1990s and then resurgence in the late 1990s and early 2000s, the overall range of values remains relatively consistent over time.

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44 Pevehouse et al. 2015.
For further insight into the variation of member states’ investment profiles, Figure 2 displays Average IO Investment Profile in a handful of international organizations over our time period. There is good variation both across different IOs, and across time within each observed IO. The EU has consistently the highest Average IO Investment Profile while the Economic Community of Central African States (ECCAS) is consistently low, with year-to-year variation in each IO’s average.
To evaluate the extent to which institutional enforcement features of IOs boost the effect of an IO’s membership profile on an increase in FDI inflows, we regenerate our main variable, Average IO Investment Profile, for organizations that have dispute settlement mechanisms that are (a) obligatory, (b) where adjudication is binding, (c) where there is a remedy for non-compliance to the ruling (either through retaliatory sanctions or through a direct effect of the court rulings at the national level), or (d) where non-state actors as well as member state actors can initiate disputes. As the COW dataset of IOs does not include this information, we use data from Hooghe et al. (2015) on 66 political and economic organizations for this part of the analysis. 30 have obligatory DSM, 21 are binding, 18 have remedies for non-compliance, and 11 allow nonstate actors standing.

Control Variables

We include additional potential confounding variables in our main estimations that are commonly used in the scholarly work on foreign direct investment. First, we control for the number of bilateral investment treaties (BITs) that a country has signed, as BITs are not included in our sample of international organizations but have been argued to provide investors with similar information. Following trends in the existing literature, we also include the log of a country’s GDP per capita, the volume of trade as a percentage of a country’s GDP, and annual economic growth (measured as the annual percent) to control for economic factors that may affect investment inflows. For political factors, we control for the quality of democratic institutions using the Polity

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45 Dreher et al. 2015; Dreher and Voigt 2011; Büthe and Milner 2014.
47 These economic indicators come from the World Bank’s World Development Indicators database.
IV data set and the existence of checks on the executive at the national level.\textsuperscript{48} We also control for whether a country experiences intra-national conflict, as conflict can negatively impact the attractiveness of a country to foreign investors. Data are from COW. Descriptive statistics are available in Appendix A.

\textit{Model Specification}

The time-series cross-sectional nature of the data raises concerns about heteroscedasticity and serial correlation. We estimate a panel model with country fixed effects, and thus only use the within country variation over time to identify the effects. The fixed effects estimator controls for unobserved country heterogeneity that is constant over time. That is, our interpretation focuses on how changes in the investment profile of a given country over time affect changes in its FDI inflows (rather than comparing across countries’ investment profiles). In effect the results are equivalent to using the first difference. This procedure is warranted because the time independent country effects are significant in the regression and the results of the Hausman test suggest that alternatives would render the coefficients inconsistent and biased. The main model is specified as

\begin{equation}
Y_{it} = \alpha + \beta E_{i,t-1} + \gamma X_{i,t-1} + v_i + u_{i,t},
\end{equation}

where $Y_{it}$ denotes the amount of FDI Inflows (% GDP) for each country-year, $E_{i,t-1}$ is the variable for Average IO Investment Profile, $X_{i,t-1}$ is the vector of control variables, $\alpha$ is the constant, $v_i$ are fixed country effects, and $u_{i,t}$ is the error term. The coefficients for $E_{i,t-1}$ and $X_{i,t-1}$ are denoted by $\beta$ and $\gamma$ respectively. We use robust standard errors to deal with problems of heteroskedasticity. Finally, we conducted a number of outlier tests and excluded any outliers in the main analyses presented here.\textsuperscript{49}

Although we keep the main models parsimonious, we show that our results are consistent if we add further control variables, use a generalized methods of moments method (GMM) to account for endogeneity, random effects, year fixed effects or high-dimensional country-year effects, and lagged dependent variable models. We also estimate the models on de-trended data and regional IO-restricted samples (to make sure the effects are not driven by the universal IOs that almost every state in our sample is a member of).

\textbf{Empirical Results}

Table 1 presents the main results. Model 1 is our main model on the full sample of economic and political organizations. The table also includes the results of a GMM estimation (Model 2) and estimations where our main independent variable, Average IO Investment Profile, is calculated on the sub-samples of IOs with obligatory DSM (Model 3), binding DSM (Model 4), DSM with remedies for non-compliance (Model 5), and DSM with non-state standing (Model 6). The models fit the data well. The highly significant F-tests across all estimations indicate that the likelihood that together the variables do not exert any influence on changes in FDI inflows is very low.

\textsuperscript{48} Data for checks and balances are from Cruz et al (2018).
\textsuperscript{49} In particular, we excluded all observations for which the DFBETA tests indicate that they could be overly influential on the estimated coefficient (we use the conventional cut-off value, $2/\sqrt{n}$). The findings are robust to including those outliers. Results are available in Appendix C.
Turning to the main substantive effects, we find evidence consistent with our theoretical argument. The level of Average IO Investment Profile is positively and significantly correlated with a country’s increase in FDI inflows. A one-unit increase in a country’s Average IO Investment Profile (implying a decline in investor risk) increases FDI inflow by about 0.62 percent. In a model with standardized coefficients, a one standard deviation increase in Average IO Investment Profile would amount to an increase of 0.24 standard deviations in FDI inflows. Figure 3 plots the marginal effects. Countries that participate in networks of IOs with very risky investment profiles (value=2) attract significantly lower FDI (less than one percent) than countries that participate in networks of IOs with very low risk investment profiles (value=8), where the inflow of FDI can be expected to increase to about 4.5 percent of a country’s GDP. For example, in 2003 Switzerland’s Average IO Investment Profile was 8 and their FDI inflows amounted to 4.95 percent of their GDP; while in 1994 Belarus had an Average IO Investment Profile of 3.14 and their FDI inflows amounted to 0.07 percent of their GDP.

Table 1: Average IO Investment Profile and National FDI Flows, 1985-2012

<table>
<thead>
<tr>
<th></th>
<th>(1) All</th>
<th>(2) GMM</th>
<th>(3) Obligatory</th>
<th>(4) Binding</th>
<th>(5) Remedy</th>
<th>(6) Standing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average IO Investment Profile</td>
<td>0.615***</td>
<td>0.657***</td>
<td>0.493***</td>
<td>0.458***</td>
<td>0.231*</td>
<td>0.413***</td>
</tr>
<tr>
<td></td>
<td>(0.122)</td>
<td>(0.110)</td>
<td>(0.119)</td>
<td>(0.106)</td>
<td>(0.126)</td>
<td>(0.102)</td>
</tr>
<tr>
<td># BITs</td>
<td>-0.013</td>
<td>0.002</td>
<td>0.012</td>
<td>0.008</td>
<td>0.010</td>
<td>0.011</td>
</tr>
<tr>
<td></td>
<td>(0.012)</td>
<td>(0.012)</td>
<td>(0.012)</td>
<td>(0.013)</td>
<td>(0.016)</td>
<td>(0.013)</td>
</tr>
<tr>
<td>Per Capita GDP</td>
<td>0.958</td>
<td>-0.262**</td>
<td>0.202</td>
<td>0.667</td>
<td>1.647</td>
<td>0.361</td>
</tr>
<tr>
<td></td>
<td>(0.719)</td>
<td>(0.105)</td>
<td>(0.677)</td>
<td>(0.615)</td>
<td>(1.740)</td>
<td>(0.721)</td>
</tr>
<tr>
<td>Trade (% of GDP)</td>
<td>0.052***</td>
<td>0.048***</td>
<td>0.051***</td>
<td>0.049***</td>
<td>0.077***</td>
<td>0.056***</td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
<td>(0.006)</td>
<td>(0.009)</td>
<td>(0.009)</td>
<td>(0.017)</td>
<td>(0.010)</td>
</tr>
<tr>
<td>GDP Growth</td>
<td>0.078***</td>
<td>0.071***</td>
<td>0.073***</td>
<td>0.078***</td>
<td>0.047</td>
<td>0.075***</td>
</tr>
<tr>
<td></td>
<td>(0.019)</td>
<td>(0.020)</td>
<td>(0.015)</td>
<td>(0.015)</td>
<td>(0.028)</td>
<td>(0.014)</td>
</tr>
<tr>
<td>Internal Conflict</td>
<td>-0.127</td>
<td>-0.197</td>
<td>-0.067</td>
<td>0.168</td>
<td>-0.421</td>
<td>0.012</td>
</tr>
<tr>
<td></td>
<td>(0.463)</td>
<td>(0.285)</td>
<td>(0.374)</td>
<td>(0.299)</td>
<td>(0.516)</td>
<td>(0.358)</td>
</tr>
<tr>
<td>Polity</td>
<td>0.034</td>
<td>0.039</td>
<td>0.024</td>
<td>0.039</td>
<td>0.043</td>
<td>0.032</td>
</tr>
<tr>
<td></td>
<td>(0.034)</td>
<td>(0.025)</td>
<td>(0.036)</td>
<td>(0.034)</td>
<td>(0.063)</td>
<td>(0.034)</td>
</tr>
<tr>
<td>Checks</td>
<td>0.091</td>
<td>0.009</td>
<td>0.065</td>
<td>0.022</td>
<td>0.079</td>
<td>0.065</td>
</tr>
<tr>
<td></td>
<td>(0.095)</td>
<td>(0.068)</td>
<td>(0.091)</td>
<td>(0.069)</td>
<td>(0.100)</td>
<td>(0.095)</td>
</tr>
<tr>
<td></td>
<td>(5.242)</td>
<td>(0.904)</td>
<td>(4.964)</td>
<td>(4.644)</td>
<td>(13.381)</td>
<td>(5.335)</td>
</tr>
<tr>
<td>R²</td>
<td>0.161</td>
<td>0.167</td>
<td>0.169</td>
<td>0.135</td>
<td>0.169</td>
<td>0.169</td>
</tr>
<tr>
<td>Observations</td>
<td>3496</td>
<td>3496</td>
<td>3230</td>
<td>3224</td>
<td>2349</td>
<td>3232</td>
</tr>
</tbody>
</table>

DV: FDI Inflows
Standard errors in parentheses
*p < 0.10, **p < 0.05, ***p < 0.01
One concern with the interpretation of these results is omitted variable bias (OVB). It is possible that factors that drive FDI inflows in a country could also incentivize its leader to become more or less embedded in IOs with different levels of investment risk. For example, countries that receive greater FDI inflows could be more likely to seek membership in IOs with safer investment profiles. Even if Average IO Investment Profile had no independent effect on FDI inflows, the selection on unobservables could lead to falsely positive results. In our case, OVB could be the result of a common trend where a group of countries experiences an increase in their investment profiles, which could create the appearance of a positive effect even though this effect is related to unobservable factors. Or a group of countries with low-risk investment profiles could create an IO, which could create a similar false interpretation.

Because we do not have a good instrumental variable for Average IO Investment Profile, we use a two-step system Generalized Methods of Moments (GMM) estimation to deal with the possibility of endogeneity. GMM was designed to deal with panel data that exhibit autocorrelation: the system estimator restricts the correlation between the error term and all explanatory variables to zero, thus dealing with possible bias from serial correlation.\(^{50}\) It allows us to deal with the possibility of endogeneity by using moment conditions to derive a set of valid instruments for endogenous variables based on past values of those variables. We re-estimate our main model using a two-step system GMM estimator with Windmeijer-corrected clustered standard errors and assume that Average IO Investment Profile is endogenous and that the remaining regressands are predetermined but not strictly exogenous. GMM can produce such a large instrument matrix that the estimator could overfit our endogenous variables. To test the validity of our instrument set, we conduct a Hansen-J test of over-identifying restrictions. The null hypothesis is that the instruments

\(^{50}\) Arellano and Bond 1991; Arellano and Bover 1995.
are uncorrelated with the error terms (that is, they are valid instruments), and rejection of the null hypothesis means that the instruments are not valid. Anything greater than $p=0.10$ indicates valid instruments. In our case, we can reject the null hypothesis which indicates that our instruments are valid ($p=0.114$). To test for the possibility of serial correlation in the error term, we use the Arellano–Bond test for autocorrelation in first-differences. We construct our model such that the error term is the first difference of serially uncorrelated errors; although first-order serial correlation is probable, it would not affect the consistency of the estimator. Second-order autocorrelation, however, would indicate that the lags of our dependent variables, which we use as instruments, are in fact endogenous. Indeed, the model results indicate that even though there is first-order correlation (AR(1), $p=0.003$), there is no second-order correlation in our models (AR(2), $p=0.625$). The main results are robust to using a GMM specification, both with respect to significance and substantive effect and are displayed in Model 2 of Table 1.

Models 3-6 analyze our argument regarding dispute settlement mechanisms. For all four different characteristics of settlement we find a strong and positive effect of Average IO Investment Profile, which supports our argument that enforceability can further augment the flow of investment.

The control variables in the main Model (1) are broadly consistent with previous studies on FDI inflows. Countries that grow more and are more open to trade are more likely to witness a significant increase in their FDI inflows over time (a one standard deviation increase in trade is correlated with a 0.32 standard deviation increase in FDI inflows; a one standard deviation increase in GDP growth is correlated with a 0.07 standard deviation increase in FDI inflows). The remaining control variables are insignificant, likely reflecting that some of these effects are captured in the fixed effects. Noteworthy is that BITs by themselves are never significant in any of our estimations, which mirrors some of the existing findings in the literature and casts further doubt whether BITs alone generate credible commitments.

Robustness

In the appendix, we provide further tests to check the robustness of our main results. In Appendix B, Model 1 estimates our main model but includes a lagged dependent variable (LDV). Model 2 estimates random effects instead of fixed effects. Model 3 lags all independent variables by one year, which should further reduce concerns about endogeneity. Model 4 uses high-dimensional country-year fixed effects. One main concern is that the effect of Average IO Member Investment Profile may be driven largely by a country’s engagement in international organizations and less by the characteristics of the membership within these organizations. In order to control for this possibility, we control for a country’s overall engagement with the organizations in our sample with a variable that measures the share of organizations a country is a member of in any given year (IO membership rate) in Model 5. This variable allows us to isolate to what extent the country’s degree of participation within existing international organizations has an independent effect from the different signals that these IOs may send based on the investment profiles of their membership. Model 6 controls for the country’s own investment profile to show that the effect of a state’s co-members’ investment risk profiles is not a result of any correlation with a state’s own investment profile.\footnote{Like our main independent variable, data on individual country’s investment risk profiles comes from the ICRG.}

The results of our main independent variable are robust across all these specifications.
In Appendix C, Model 1 controls for whether a country is a member of the WTO and Model 2 controls for the number of veto players in a country.\textsuperscript{52} In Model 3, we use alternative FDI data provided by UNCTAD, Model 4 excludes all OECD countries, and Model 5 excludes all countries with populations smaller than one million. Finally, Model 6 includes all outliers that we excluded from the main analysis. The results are robust.

In our theory, we argue that membership in IOs with a low-risk membership portfolio boosts a country’s credibility for foreign investors, thus leading to a rise in investment. In our main estimations, we use the average of the IO membership investment profile. In Appendix D, we show that using the median IO investment profile leads to the same findings (Model 1). In addition, we report estimations where we measure our main variable as the maximum investment profile (lowest risk) of members in an international organization (Model 2). The effects are positive and significant across these alternate specifications. Finally, Models 3 and 4 demonstrate that the effect of Average IO Investment Profile holds separately across both political and economic IOs in our sample. One could be concerned that the inclusion of universal IOs could render the values our main variable difficult to interpret with respect to country differences. Model 5 shows the effect also holds when only including regional political and economic IOs. One final concern is that the results could be driven by a trend that is common to all variables over time. To account for this, we follow Büthe and Milner (2008) and detrend the data by regressing the year on each variable and rerunning our main model using the residuals from these regressions (Model 6); our main results hold.

Conclusion

This paper provides an important step in our understanding of the interaction between state participation in the global community and domestic economic outcomes. The longstanding question of how to generate foreign direct investment has clear ramifications for global welfare, especially in the developing world. Over the past three decades, global investment flows have grown rapidly, outpacing world trade and laying the bedrock for a spike in international production, now a crucial source of finance, skills, innovation and capacity for the developing world. Exactly how to generate FDI, however, remains a source of debate, as many governments are by themselves unable to overcome the credible commitment problems needed to convince investors that their ventures are safe. In response, states have created and are joining a growing number of international institutions designed specifically to attract investment and mute the credible commitment problem that governments often face. Even among those agreements—BITs, TIPs and some trade agreements—there remains debate and conflicting evidence about whether and how international institutions might help members attract investment.

Our paper complements that body of literature in several ways. First, we broaden the discussion beyond investment-specific agreements and provisions to the economic and political IOs that govern the market and governance environments more broadly, organizations that are required to define and secure property rights and a healthy and reliable regulatory system. We show that membership in this wider set of organizations has the ability shape a state’s public image and affect its trustworthiness. Membership in political and economic IOs can provide investors with information that helps to mute the credibility problems that deter investment.

\textsuperscript{52} WTO data from Graham and Tucker 2019. Data on veto players from Henisz 2000.
We also explain why, and empirically show that, membership in this broader set of organizations facilitates FDI under two specific conditions. First, membership in IOs composed of low risk members are more likely to provide information about a member state’s reliability—membership in an IO with high risk principals may not deter investment, but it certainly will not add an additional boost of assurance to encourage it. Second, the signal sent by cooperation with low risk states is amplified by institutions internal to the IO that provide some form of formalized enforcement mechanism. We thus merge two important strands of literature—on membership characteristics and institutional design—that have thus far remained distinct and demonstrate their complementarity. Our findings speak to broader literatures on the utility of international organizations, on the ability of states to make credible commitments in the international arena, and on the role of institutions in promoting foreign direct investment.

Perhaps the most important insight is that IOs only help generate credible signals of commitments in the global market place when they are comprised of rule followers—groups of states that operate low risk environments at home—willing to sacrifice some sovereignty to the organization by way of enforcement provisions. Putting together high-risk states may have other benefits but muting the credibility problem is not one of them. That sharply limits the scope for which the classical theory of credible commitments central to the literature on IOs applies. Groups of high-risk states, which are growing in number and degree as more and more states join IOs, are making incredible promises.
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