Hybrid Political Regime: The Fall of Foreign Direct Investment in Mexico

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Abstract
Today we can identify a variety of political and economic systems in the world. A free market economic system is more likely to work if it is based on a democratic political system. According to the Democracy Index 2021, Mexico went from being an imperfect democracy to a hybrid regime, with the risk of becoming an authoritarian regime. The transition from a political system of imperfect democracy to a hybrid regime represents a great risk for domestic and foreign private investment. There is a latent political risk for investors in this type of country, which scares away foreign direct investment.

This research presents an analysis of the behavior of foreign direct investment in Mexico from 2000 to 2021 by state and political party. A point biserial correlation test is performed to prove the existence of a dependencie between the attraction of foreign investment and the political party in government. Lower capital inflows in Mexico is observed since the presence of MORENA, actual political party that is in both, the federal and some state governments. Descriptive statistics show that in most of the matches there is a dependence and also a correlation, however it is prudent to study the direction of this relationship and the strength.

The findings are based on an analysis of three years of government of the MORENA political party; therefore, a longer period could be considered for future research.

Introduction

This research studies the relationship between Mexico's current political regime and the attraction of foreign direct investment (FDI). A positive relationship is understood as one in which the governmental political regime influences an increase in the attraction of FDI, while a negative relationship is understood as one in which the government influences a reduction in the attraction of foreign capital, generated mainly by the distrust that investors have to invest in a given country.

To address this research, the following question is posed: ¿does Mexico's current political regime positively or negatively influence FDI attraction? Several authors have studied the characteristics of democratic and authoritarian political regimes that exist in the world, although there are political systems that are in a transition towards democracy or authoritarianism. Recently, Mexico has been classified as a country with a hybrid political system. According to The Economist magazine, a hybrid political system has a mix of democratic and authoritarian characteristics. This category defines regimes that are not classified as full democracies.

We cannot deny that political systems and economic systems are connected. Democratic political systems are linked to market economies while other political regimes are related to government-controlled economic systems.

Literature Review

According to Naranjo (2021), a political regime can be divided into several elements such as organized society, institutions that represent different political powers, the understanding of political activity through different values of society and involvement in the international arena.

Nowadays, we can identify in the world democratic and authoritarian political regimes. Democratic political regimes are characterized by the rule of law, free elections, human rights, division of powers, access to public information, non-partisan bureaucracy, freedom of the press, freedom of expression. In "International business" (Hill and Hult, 2019) describes authoritarian regimes as systems where freedom of expression, free elections, freedom of the press are denied to citizens but also there is a tendency to the concentration of power in a single person. The economic success of a country is based on a democratic political system, while authoritarian governments are characterized by economic distortions such as lack of domestic and foreign private investment, lack of gross domestic product (GDP), and a lack of economic growth. The stability of political regimes may have an influence on the development of economic variables (Naranjo, 2021).

Country risk can be defined as the possibility of unexpected incidents occurring in a country, which may hinder investors' decision making (Topal and Gül, 2016). It can be classified according to the type of debtor (sovereign or non-sovereign), or according to the type of risk (political, economic, and financial) (Morales and Tuesta, 1998). FDI has an inverse relationship with seven indicators of political risk in almost all income groups, most notably government stability, socioeconomic conditions, and corruption. Higher economic risk is significantly related to lower FDI (Elizalde et. al, 2022). Regardless of the social process in other dimensions, political turmoil can deter FDI (Strusani, 2014).

In recent decades, Latin America has experienced moments of political uncertainty. There is still uncertainty about the development of democracy in the region, although the trend towards the future is particularly delicate and full of dangers. The risks of moving towards or returning to more authoritarian conceptions are evident (Chinchón, 2007). This demonstrates the democratic decline of the region and the continent. Jensen (2003) argues MNCs prefer to invest in democracies because policy makers' incentives align with MNCs' interests. The accountability created by robust democratic institutions assures MNCs that future leaders will honor commitments and maintain stable policies.

The Democracy Index, published annually by the British magazine The Economist, reports the state of democracy in the world and divides countries into four categories: perfect democracy, imperfect democracy, hybrid regime and authoritarian regime. According to this index, Mexico has moved from an imperfect democratic political system to a hybrid political system. This is why it is important for this research to analyze the consequences of this change of political regime in Mexico in terms of attracting foreign direct investment, since according to the literature, authoritarian or transitional political regimes scare away foreign capital. Country risk is a variable to be considered by foreign investors and political regimes in transition do not give a good signal to international markets.

Low corporate quality and political corruption decrease the profitability of investments, as they represent high levels of costs and uncertainty for Multinationals. It is worth mentioning that political consistency, social compliance, bureaucratic quality, level of corruption and democracy are the most considered factors in the corporate quality of a country (Iloie, 2015).

The lack of economic and social results in countries with a democratic political regime is an opportunity for authoritarian regimes to capture the interest of those citizens who feel that their demands have not been met by democratic governments. But, as (Rafat and Farahani, 2019) argue it is important that political parties and stakeholders take into account the fact that aggravation of political situations in the country would lead to an overall negative impact.

Political Risk

Asiedu (2006) agrees that corruption and political instability have a negative impact on attracting foreign direct investment. The politic´s stability of a country´s government (Filipe et al., 2012:117) is often determinant to have investments, particularly the ones from an international company.

Saravia (2015), assesses the impact of political regime stability, as measured by political regime experience or the number of years a particular political regime has been in place, on the adoption of institutions of economic freedom. As Mezú (2020) says that the best remedy for economic development is democratic strength. In this sense, the greater the social freedoms, the greater the opportunity for a nation's growth. However, with the rapid development of the Asian tigers, where democracy is not the common denominator, development is not necessarily attributed to democracy but to the structure of institutions.

Economic and political factors enter into the decision by multinational corporations of where to invest. Political risk has become an umbrella term that aggregates the effects of a wide range of political factors (Jensen and McGillivray, 2005). Higher economic risk is significantly related to lower FDI; high inflation rates and higher budget and current account deficits can lead to economic instability, and as a result to a decrease in the real value of investments (Elizalde et. al, 2022). Hayakawa et al. (2011) study the effect of political and financial risk on FDI in eighty-nine countries, sixty-three of which were developing countries (including Mexico). The results of the dynamic model indicate that high levels of political risk decrease FDI inflows. Authoritarianism is a risk of politics, regardless of the electoral system. The need to provide false security and the idea of a fictitious people are two of the central elements that make authoritarianism its raison of existence (Korstanje, 2013). According to Korstanje (2013), authoritarian governments seem to demonstrate a certain sensitivity to issues that affect the welfare of all. As a general rule, they denounce social injustices or economic problems that have been inherited from previous mandates or simply generated by themselves in the full exercise of their powers.

Such is the case of the cancellation of the construction of the Constellation Brands plant in the city of Mexicali in March 2020 as a result of a populist survey promoted by the mexican President Andrés Manuel López Obrador. This cancellation generated distrust and uncertainty among domestic and foreign investors. Another example of a disappointing issue is the recent approval in May 2022 in the Mexican Senate of a bill to nationalize lithium mining and extraction as a protectionist policy. With this protectionist measure, Mexican state-owned companies will have exclusive rights to mine lithium, which is a critical mineral used in electric car batteries, as well as for other next-generation technologies. USA congressional republicans and democrats see that those actions are violating the economic and legal rules governing U.S.-Mexico relations. On the other hand, the behavior of the government related to foreign direct investment in Mexico has not always been negative. That is to say, even with an imperfect democratic political system before the arrival of the MORENA political party to power, Mexico consistently attracted high investment flows (CEPAL, 2021). Likewise, Naranjo (2021) argues that the upward trend in foreign direct investment leads to greater stability of political regimes and strong democracies are the most important for attracting investment.

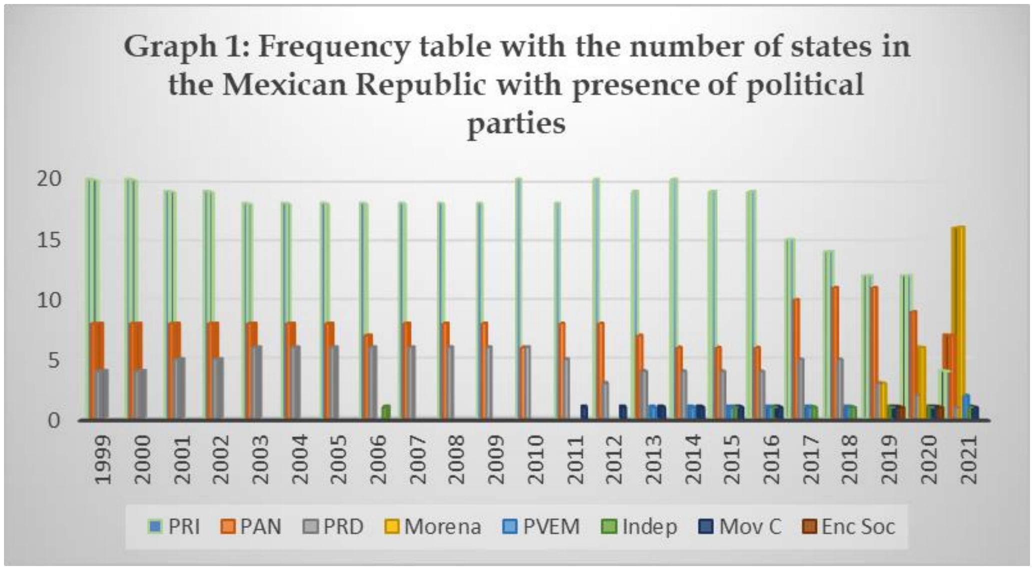
Mejía (2005) found that the presence of infrastructure has contributed to the fact that –for the case of Mexico- only a few states have benefited from FDI, despite the fact that some other variables (corruption and political and labor instability) may have had adverse effects on FDI flows (considering that the period studied is between 1989-2001 and MORENA political party has not been founded). While it is true that an authoritarian government scares away investments, Mexico has powerful elements that help it counteract such effects, such as the ratification of the signing of the USMCA, the strengthening of the U.S. economy (recovering from the COVID-19 health crisis) and the reconfiguration of global value chains would place Mexico in a better position to undertake processes of proximity offshoring and relocation of production centers to countries more akin to the poles of investment and consumption (CEPAL, 2021).

Research methodology

Descriptive statistics

Mexico has a political system formed by several left-wing and right-wing parties. Over the years in the time series studied, several political parties have been incorporated into the Mexican political system. From 1999 to 2010, there were only 3 political parties (PRI, PAN, PRD) that predominated in the national scenario. Subsequently, 4 political parties (PVEM, MOV C, ENC SOC, MORENA) and also independent candidates were incorporated (Table 1). Each of the 32 states that make up the Mexican Republic is represented by a political party. Graph 1 shows the political parties with the largest and smallest presence in the 32 states from 1999 to 2021.

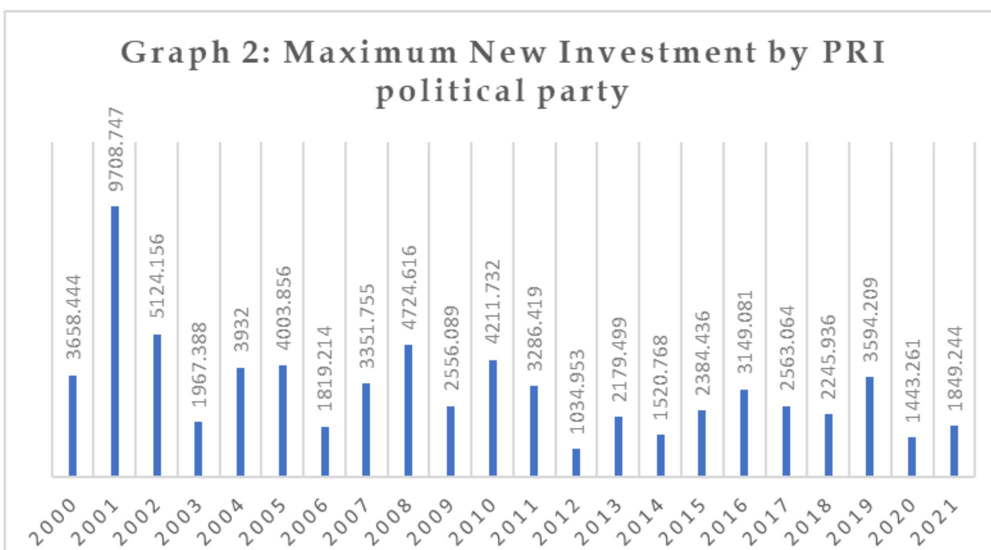
The political party with the largest presence is the Institutional Revolutionary Party (PRI, right-wing). In second place is the National Action Party (PAN, right-wing). But, as of 2019, the leftist political party Movimiento de Regeneración Nacional (MORENA) has presence in several states until achieving presence in 2021 in 16 states.



Source: Prepared by the authors with data from the National Electoral Institute.

On the other hand, every political party that governs a state in Mexico makes its own effort to attract foreign direct investment, regardless of the public policy that governs at the national level.

In Graph 2, the PRI political party is the one that attracted the most foreign direct investment in the time series studied, i.e., in the states governed by this political party in 2001 it attracted $ 9.70 billion U.S. dollars.



Source: Prepared by the authors with data from the National Electoral Institute and Ministry of Economy of Mexico

The most popular political parties in Mexico are more likely to attract high inflows rather than the most unpopular ones.

Objective

The objective of this research is to find the relationship between the attraction of foreign direct investment in the 32 states of the Mexican Republic and the ruling political party.

Variables

For the present work, the test was carried out in the STATA statistical software, so the variables were specified as follows.

Y: "New foreign direct investment".

X: Presence of a political party in question.

In STATA we studied the results obtained for the P-value as well as for the value of Pearson's coefficient, as for the first value, this indicates us from a hypothesis test that is posed below, the dependence of the new foreign investment and the presence of the political party in question; as for the value of the coefficient, we can find the type of relationship that exists between one variable and another, as well as its strength and direction.

Hypothesis Test.

P-value <α→Rejection of Ho.

P-value ≥α→No Rejection of Ho

Ho: There is independence between the new investment and the presence of the party in question.

Ha: There is dependence between the new investment and the presence of the party in question.

Data

A database was constructed from 1999 to 2021 for each state of the Mexican Republic with the inward flows of foreign direct investment and the political parties in government during that period of time. A point biserial correlation was used for this research.

The point biserial correlation is a correlation coefficient that analyses and studies the product-moment correlation between one binary (dichotomus) variable and a standard continuous variable. It is important to mention that the binary variable does not follow any natural ordering criteria, that is, the variable does not gets affected if it's categorized as a 1 or a 0; another important asumption is that the continuous variable follows a normal distribution.

This type of correlation is used when it is needed to analyse a continuous variable versus a dichotomus variable, this can be binarized in order to get a better analysis of the data.

The correlation takes the following form where Y represents a continuous random variable and X represents a binary random variable that takes the values of 0 and 1.

Also n represents $(Y_k, X_k), k = 1,2, \dots, n$.

$$rpb = (\frac{Y_1 - Y_0}{S_y})\sqrt{\frac{np_o(1-p_o)}{n-1}}$$

Were

$$S_y = \sqrt{\frac{\sum_{k=1}^{n}(Y_k - Y)}{n-1}}$$

$$Y = \frac{\sum_{k=1}^{n} Y_k}{n}$$

$$p_1 = \frac{\sum_{k=1}^{n} X_k}{n}$$

$$p_0 = 1 - p_1$$

Findings/results

After having calculated the p value we can say that the political parties PRI, PAN and PRD have a p value of 0.0008, 0.0001 and 0.0002 respectively and a confidence interval of 99% (Table 2) which demonstrates the dependence of the attraction of foreign direct investment according to the political party in question, that is, the states that were governed by one of these three political parties attracted more investment, so we can say that the hypothesis of dependence is accepted. Likewise, the Pearson coefficient is positive for the PAN political party and shows that the new foreign direct investment attracted by the states governed by this political party is strong and constant.

On the other hand, states governed by the rest of the political parties attracted less foreign direct investment than the other political parties. The confidence interval was 95% for the resto of the cases. MORENA, PVEM, ENC SOC, MOC S, INDEP got 0.0156, 0.1021, 0.306, 0.828, 0.027 as a p value.

Discussions and conclusions

The PRI is a political party that governed Mexico for more than 70 continuous years and during these years public institutions were built that provided legal certainty to citizens but also to companies. However, Mexican society demanded a change of government because it wanted to know if the country could improve. This was how from 2000 to 2012 the PAN political party won the presidential elections highlighting a period of political stability but in 2012 again the PRI came to power and in 2018 a sufficient number of voters tired of corruption decided to vote for the MORENA political party (radical left) which after three years of government, Mexican society is extremely disappointed with all the actions taken by one man. The current government gives negative signals to the international environment especially to investors who see Mexico as a questionable investment destination.

In the time series analyzed, the states governed by the PRI, PAN and PRD attracted more foreign direct investment due to the confidence of national and foreign investors, but once MORENA came to the federal government, an image of distrust was generated for investors, which led to a reduction in the arrival of foreign capital.

Limitations and direction for future research

The time series studied contemplates 3 years of presence of the MORENA political party in 16 states of the Mexican Republic, so the information shown is considered as partial results since it does not consider at least one complete period of government in each state. Each governor is for a period of 6 years.

This research will integrate in the future the missing data to complete a governmental period of 6 years and have a time series with complete governmental periods by the different political parties.

Appendices

Table 1

The number of states governed by the political party in question

Year	PRI	PAN	PRD	Morena	PVEM	Indep	Mov C	Enc Soc
1999	20	8	4					
2000	20	8	4					
2001	19	8	5					
2002	19	8	5					
2003	18	8	6					
2004	18	8	6					
2005	18	8	6					
2006	18	7	6			1		
2007	18	8	6					
2008	18	8	6					
2009	18	8	6					
2010	20	6	6					
2011	18	8	5				1	
2012	20	8	3				1	
2013	19	7	4		1		1	
2014	20	6	4		1		1	
2015	19	6	4		1	1	1	
2016	19	6	4		1	1	1	
2017	15	10	5		1	1		
2018	14	11	5		1	1		
2019	12	11	3	3		1	1	1
2020	12	9	2	6		1	1	1
2021	4	7	1	16	2	1	1	

Table 2

Political Party	Pearson Coef	P value	Conf Level
PAN	0.107	0.0001	99%
PRI	-0.063	0.0008	99%
PRD	-0.0701	0.0002	99%
MORENA	0.0453	0.0156	95%
PVEM	-0.0306	0.1021	95%
ENCUENTRO S.	-0.0192	0.306	95%
MOVIMIENTO C.	0.0041	0.8288	95%
INDEPENDIENTE	0.0412	0.0278	95%

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