

Insecurity and political uncertainty: Factors that Influence the Fall of Foreign Direct Investment in Mexico

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Abstract

One of the fundamental aspects of any government is to have a national development plan that establishes the guidelines that will guide the destiny of the nation. In the case of Mexico, each six-year presidential term has a national development plan that may or may not have continuity, where one of its main objectives is economic growth.

The attraction of foreign direct investment is one of the pillars of economic growth, however, it can be affected by various national and international factors. This research analyzes the behavior of foreign direct investment during four presidential terms in Mexico from 1999 to date. The first twelve years were governed by the national action party (PAN, right wing political party), from 2012 to 2018 by the institutional revolutionary party (PRI, center-right political party) and from 2019 to date by the MORENA political party (left wing political party). The methodology applied for this research was an autoregressive process of order one.

We highlight that the arrival to the presidency by the PAN in the year 2000 brought large flows of foreign capital during its six-year term, however, during the period from 2006 to 2012 also governed by the PAN there is a decrease in the attraction of FDI of 27% in relation to the previous period. Likewise, a 16% drop in FDI is also observed during the period from 2012 to 2018 governed by the PRI and a drop of almost 5% from 2019 to date, a period governed by the political party MORENA.

As a conclusion, we can argue that the drop in FDI in the period studied can be attributed to various factors such as organized crime as well as the distrust of investors derived from the arrival of a leftist political party to the government.

Introduction

In Mexico, since 1928 and to date, each presidential term is 6 years and each president is democratically elected in free and open elections and cannot be reelected. This research analyzes the behavior of foreign direct investment inflows into Mexico from 1999 to 2022 derived from the public policy actions of the political party that governed Mexico in those years. Thus, in the period studied, we can identify four presidential periods ranging from 2000 to 2006, 2006 to 2012, 2012 to 2018 and 2018 to 2024. In the first two periods, the elected presidents corresponded to the National Action Party (PAN), the third period to the Institutional Revolutionary Party (PRI) and the last period to the National Regeneration Movement (MORENA). Each president designs a national development plan with different purposes depending on the situation prevailing in the country. For example, President Vicente Fox (2000-2006), recognized that Mexico was in a process of profound change framed in four major transitions such as demographic, economic, political and social. The economic transition was driven by the globalization of the economy as a result of fundamental changes in the nature of economic activity. This represented a great challenge for the country because while there was an increase in international trade and finance, Mexico still maintained an inward development strategy. The late incorporation to the new processes forced Mexico to initiate the change in its economy through a rapid and deep unilateral and multilateral opening to trade and financial

flows. Foreign investment became one of the most important factors for economic development and both the government and national companies had to adopt international thinking. Development policy was based on attracting foreign direct investment. Along with the economic transition came the political transition as a result of a long road towards the democratization of the country, forming a plural regime with alternation, strengthening and independence of the legislative and judicial powers, thus improving the image and confidence of the government at the international level. It is important to highlight that the governmental model continued in the following six-year term (2006-2012) but with a fundamental characteristic that has changed the course of the country to date. Eleven days after becoming president, Felipe Calderón Hinojosa decided to make a radical change in the way the drug trafficking problem was being handled. It is said that in the previous six years there was a pact between the drug cartels and the government, which President Calderon was not willing to continue and decided to declare war on the cartels. This declaration caused a drop in foreign direct investment flows due to the wave of insecurity prevailing in the national territory, which multinational companies were not willing to face. This national situation contributed to the arrival of Enrique Peña Nieto as president of Mexico for the next six years (2012-2018) on behalf of the Institutional Revolutionary Party.

A change was made in the strategy against insecurity that not only did not work, but brought an increase in the national wave of violence. This six-year term was characterized by disgraceful acts of corruption, which added to insecurity, further damaged Mexico's image abroad, thus affecting the arrival of capital inflows. The society fed up with the insecurity and corruption of the previous six years decided to give the vote of confidence in the 2018 elections to the now President Andrés Manuel López Obrador. It was thought that with the arrival of a different social leader the great national problems would be abated, but this was not the case. On the contrary. They got worse. The current government has been a great disappointment for citizens because now they have to deal with a government that apart from not solving any of the previous problems is now feared for the transition from a political system with an incipient democracy to a hybrid political system. This research provides a theoretical framework in chapter two, then presents the methodology used to identify the behavior of foreign direct investment in Mexico from 1999 to 2022. Chapter four presents the results and findings, and chapter five presents the conclusions and future discussions.

Literature review

Recently, Mexico has been classified by the Democracy Index published by The Economist magazine as a country with a hybrid political system that has a mix of democratic and authoritarian characteristics. Botello (2023) found that a country's economic success is based on a democratic political system, while authoritarian governments are characterized by economic distortions such as a lack of domestic and foreign private investment, a lack of gross domestic product (GDP), and a lack of economic growth. Authoritarianism is a risk of politics, regardless of the electoral system. 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. Naranjo (2021), argues that stability of political regimes may have an influence on the development of economic variables. Likewise Turedi (2018), concludes that decreased economic and political risk accelerate FDI inflows.

According to Tyson (2018), in an FDI-friendly policy environment, more political constraints will attract FDI inflows while in a negative policy environment the reverse may hold true.

Tomashevskiy (2017), found that some investors prefer to invest in nondemocratic countries rather in democratic countries. But most of the literature matches with the idea that democratic regimes captures more FDI.

The determinants creation theory proposed by Botello (2015), identifies the determinants most used by countries to attract FDI. Within these determinants we find infrastructure, natural resources, geographic location, labor force and among others is the determinant related to security. Insecurity is a determinant that affects the attraction of FDI as it represents a high risk for investors. Cabral et.al, 2019 found in his research that crime affects the business decision to invest in a high-crime country. In his paper, Cabral et.al,

(2019) used the premise by Detotto and Otranto (2010): “Criminal activity acts like a tax on the entire economy: it discourages domestic and FDIs, it reduces firms’ competitiveness, and reallocates resources creating uncertainty and inefficiency.”

Mexican President Felipe Calderon took office in December 2006. From the outset, his government deployed an aggressive security policy to fight drug trafficking organizations in what became known as the “Mexican Drug War.” (Bel and Holst, 2018). But, regardless of the results of these decisions, the reality is that FDI has contracted significantly.

Mexico has experienced a proliferation of powerful drug cartels and an upsurge of violence in the last two decades (Chapa, Ayala and Medellín, 2023). The reasons for violence in Mexico are diverse. Variables such as the poverty rate, unemployment, and weak institutions all play an important role (Bel and Holst, 2018). They also agree that the adoption of the “Drug War” strategy has resulted in significant negative effects on the economic growth of Mexico as well as Benton (2017).

Several authors have investigated the key factors that influence investors in order to make decisions about where to take their investments. According to Bellinger and Son (2019), potential investors pay close attention to the domestic governing environment of host countries, because such environment can reveal important information related to the protection of their investments. And it is found that countries with less corruption are at the same time the main origin and destination of these capitals. (Flores and Neme, 2020). Also, criminal activities tend to introduce risk and uncertainty, which can increase the expected cost to foreign investors. (Brown and Hibbert, 2017).

Miranda et.al, (2022) found that the quality of the government impacts in a positive or negative way the attraction of foreign direct investment. Besides that, Dasic (2022) also found that the determinants, such as political terror scale and the control of corruption, have significant and plausible effects in the Balkan and non-Balkan countries in transition for foreign capitals attraction.

Regarding Latin American countries, the transition to democratic governments over the last 25 years has led to significant improvements in institutional quality. However, the surge in crime could work against the positive effects that better institutions have on FDI inflows in the region. (Blanco, Ruiz, & Wooster, 2019).

Research methodology

For this research, we used a database with inflows of foreign direct investment from 2000 to 2023 in Mexico; it also included the political party that governed in each of the presidential periods.

It was very useful an autoregressive process for this research (AR), because this kind of model describes the evolution of a variable over time based on its own past values. The autoregressive term derives from the idea that a variable regress to itself.

Then, our model is as follows:

$$fdi_t = \beta_0 + \beta_1 fdi_{t-1} + u$$

Where:

fdi_t → Represents the foreign direct investment (FDI) for the actual period.

fdi_{t-1} → Represents the foreign direct investment (FDI) for the past period.

u → Represents the unobservable variables or error term.

To estimate the autoregressive coefficients β_i , we used the method of ordinary Least Squares (OLS). Once the parameters were calculated, the autoregressive model was helpful to make future predictions of the dependent variable, in this case, Foreign Direct Investment (FDI), based on its own past values. It is important to note that while autoregressive models can be useful in many situations, they also have limitations, such as the assumption that data follow an autoregressive pattern and the inability to capture

complex relationships between variables. Therefore, it is essential to choose the appropriate model according to the context and consider other modeling techniques when necessary.

In this research, we found that Foreign Direct Investment (FDI) could be modelled as an autoregressive process because this variable refers to investment made by individuals, companies, or governments from one country into another country. FDI can be influenced by various economic, political and social factors, and its behavior might not be solely determined by its own past values, which is the primary assumption of autoregressive models. So, in this research our main suppose is that, the FDI of a past period, determines the future decisions for implement the next period of FDI, in Mexico.

Additionally, FDI data might exhibit non stationary behavior, trends, or seasonality, which would require appropriate preprocessing and modeling techniques to address these characteristics.

In summary, while an autoregressive model can be considered as part of a broader analysis of FDI data, it's crucial to assess the specific characteristics of the data and the factors that influence FDI to choose the most suitable modeling approach.

Findings/Results

The first governmental period analyzed in this research was that of President Vicente Fox from 2000 to 2006. In this period the accumulation of FDI was \$83,247 US billion dollars (Table 2A). Of the four periods analyzed, it is the one that attracted the most foreign investment. During those years, criminality was under control, which is why foreign investors continued to have confidence to invest in Mexico, in addition to the fact that a different political party came to power. The second period was governed by President Felipe Calderón who accumulated \$65,551.4 US billion dollars (Table 3A), which meant a 27% drop (Table 6A) in relation to the previous period. Although there was a drop in FDI in this period, Table 9A shows a positive relationship in the coefficient which means that the attraction of foreign investment was maintained. The drop is attributable to the president's declaration of war against the drug cartels. In those years, Mexico's image abroad was very bad, which caused investors' distrust.

The distrust in investors continued in the following two periods and the negative coefficient shows it (Tables 10A and 11A). In the period of President Enrique Peña Nieto (2012-2018) foreign investment fell by 16% in addition to the 27% of the previous period, attracting only \$ 56,465.30 US billion dollars and in the current government investment also fell by approximately 5% with an attraction of \$ 53,785.00 US billion dollars.

Discussions and conclusions

This research demonstrates the drop in the attraction of foreign direct investment that Mexico has been registering from 2006 to 2023. The negative coefficient in Table 7A for the four periods studied reflects that foreign direct investment has been decreasing over the years. Insecurity is a determinant that continues to cause this decrease, despite the fact that the current government promised to have a safer country, the truth is that this promise has not been fulfilled, on the contrary. But, not only security has not improved, but also some authoritarian signs have contributed to the distrust of investors. The effect of the pandemic is not considered as a determinant affecting the arrival of capital because the data show that there was foreign investment in Mexico. At the international level, countries registered drops in their investment, but there are other causes that could have affected the arrival of capital.

Limitations and direction for future research

This research presents results at the national level, but not at the state level. A detailed study of the behavior of foreign direct investment by each of the 32 states of the Mexican Republic governed by different political parties in the same period of time analyzed from 1999 - 2023 will be offered later on. This study will present the details of the presence of insecurity in the national territory and will be contrasted with the attraction of foreign capital.

Appendix

Table 1A

Descriptive statistics: period 1999-2022	
Average	\$3,091.80
Standard deviation	\$2,423.60
Maximum	\$15,444.60
Minumum	-\$2,433.20
TOTAL	\$296,812.00

Table 2A

Descriptive statistics: period 2000-2006	
Average	\$3,468.60
Standard deviation	\$2,834.30
Maximum	\$15,078.70
Minumum	\$896.50
TOTAL	\$83,247.50

Table 3A

Descriptive statistics: period 2006-2012	
Average	\$3,450.10
Standard deviation	\$1,572.30
Maximum	\$6,678.90
Minumum	\$1,056.00
TOTAL	\$65,551.40

Table 4A

Descriptive statistics: period 2012-2018	
Average	\$2,971.90
Standard deviation	\$3,729.30
Maximum	\$15,444.60
Minumum	-\$2,433.20
TOTAL	\$56,465.30

Table 5A

Descriptive statistics: period 2018-2024	
Average	\$3,163.80
Standard deviation	\$1,762.90
Maximum	\$8,816.10
Minumum	\$799.40
TOTAL	\$53,785.00

Table 6A

Growth of FDI in whole periods		
Period 2000-2006	\$83,247.50	
Period 2006-2012	\$65,551.40	-27.00%
Period 2012-2018	\$56,465.30	-16.09%
period 2018-2024	\$53,785.00	-4.98%

Table 7A. Stata's results for autoregressive model in whole period (1999-2023).

fdit	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
fdit-1	-0.0208	0.0038892	-4.25	0	-0.01236	-0.02765
_cons	3163.3	50.08158	3.24	0.001	63.58877	4260.5372

Table 8A. Stata's results for autoregressive model in first period (2000-2006).

fdit	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
fdit-1	0.0187	0.08912	5.15	0	0.00235	0.03284
_cons	3498.1	20.8581	7.32	0.001	50.6597	5832.6726

Table 9A. Stata's results for autoregressive model in second period (2006-2012).

fdit	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
fdit-1	0.1144	0.019125	6.21	0	0.000525	0.21845
_cons	2839.4	14.6771	5.41	0.001	20.4597	3321.5425

Table 10A. Stata's results for autoregressive model in third period (2012-2018).

fdit	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
fdit-1	-0.2145	-0.1176	5.15	0	-0.1542	-0.31632
_cons	3578.3	22.4789	7.32	0.001	15.4597	4216.2525

Table 11A. Stata's results for autoregressive model in forth period (2018-2023).

fdit	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
fdit-1	-0.2261	0.002345	4.15	0	-0.00781	-0.55442
_cons	2488.2	31.8989	8.32	0.001	2.35287	2001.7678

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