6 Conclusion and Outlook
This volume analyzed the influence of political risks and the institutional environment on the investment decisions of foreign investors in Latin American countries. The results shed some light on the initial questions of how political risk influences the investment decisions of MNEs and what are the sources of political risk. The theoretical analysis in Chapter 2 presents a macroeconomic and a microeconomic model of investment to analyze investment behavior under uncertainty. Both models permit to derive the result that higher degrees of uncertainty have a depressing impact on investment spending, if investments are assumed to be irreversible. By extending these basic results to FDI decisions the theoretical models suggest that higher uncertainty resulting from political events should depress investment flows and that increasing political risk in countries is, all other things equal, expected to result in lower inflows of FDI.

To facilitate the analysis the author used a simple theoretical framework that allows for the study of the impact of institutional factors on FDI flows to Latin American countries and to Mexico. The empirical impact of different risk factors is assessed by examining a panel of Latin American countries for the time period from 1982 to 1997 and a case study on Mexico for the years 1982-2003. The results of the empirical analysis confirm the central hypothesis of this work that political risk has an important influence on FDI flows to Latin America, although empirical results vary largely with different risk indicators. In the panel analysis aggregate measures of political risk did not turn out to have a robust impact on incoming FDI to Latin American countries. The same result holds for classical indices of country risk based on hard macroeconomic data for the assessment of country risk. Likewise I find that societal risk variables are not robust determinants of incoming FDI to Latin American countries. In turn, governance related risk factors were found to be significant and robust determinants of FDI.

While macroeconomic risk variables do not turn out to be of importance for FDI in the panel analysis for Latin American countries, the case study on Mexico suggests the opposite. The results concerning other risk factors are more straightforward to interpret since also in the case study on Mexico societal risk factors were not found to be influential determinants of incoming FDI. Governance-related risk factors showed a positive correlation with FDI indicating that they are influential for FDI flows to Mexico.

These results are in line with the author's hypothesis that societal political risk factors are not of major importance for FDI flows to Latin America. The empirical results suggest that societal characteristics as religious or ethnic tensions, socioeconomic conditions or internal conflicts are not influential determinants of FDI. Despite of the obvious societal need to solve these problems, social reforms are no viable way to promote FDI. These findings suggest that the insignificance of aggregate political risk variables for FDI flows that has been found in many older empirical studies stems from the fact
that most risk indices contain a fraction of societal risk components with a large weight. Many of the indicators that have been used in earlier research even show a societal conflict bias that does not adequately mirror the current political and socioeconomic situation of Latin American countries. Therefore, the failure of many studies to find a significant relationship between political risk and FDI rather stems from methodological deficiencies than from the lack of relationship between the two variables.

In contrast, it is hardly surprising that the most significant and robust determinants of FDI are variables that measure political risk originating from governmental action or failure. The results of this work impressively highlight the importance of good, transparent and rules based governance in Latin America as a prerequisite for the attraction of more FDI. While the reforms of the 80s and 90s were partly successful in implementing an economic order based on the market and political systems that are now more open and democratic than ever before, a second generation of reforms that ameliorate the institutional environment for business activities in Latin America is still on the way. Although officially democratic, many countries still have characteristics of authoritarian rule and weak national institutions that often hinder a proper functioning of markets and that distort private investment incentives. The qualitative analysis of the Mexican case impressively highlights how inefficiencies in government, public administration, judiciary and high levels of corruption may create an unfavorable investment climate despite of strong fundamentals as macroeconomic stability, a large domestic market, low wages and easy access to the US market. It also underlines the difficulties of overcoming ideological resistance against foreign capital, which has a long tradition in post-revolutionary Mexico and in nearly all other Latin American countries. Thus, besides a further economic liberalization, Mexico, and surely most of the other Latin American countries as well, need an institutional reform that increases the quality of national institutions and permits to attract more FDI.

The study of the Mexican case additionally highlighted that although institutional reforms were initiated the results only materialize slowly which requires a short term strategy to complement domestic institutional reforms. It was shown that Mexico successfully chose a strategy of multilateral and bilateral economic integration to mitigate high political risks. Interpreted in this way integration efforts as the membership in NAFTA not only have the static effects that are described in the theory of regional integration. Instead, integration is a valuable tool for locking in reforms against populist pressure and gaining credibility on the international stage. Furthermore integration efforts were crucial to improve the legal certainty of investors and the protection of property rights against predatory government interventions which have a long tradition in Mexican economic policy. The impressive increase of FDI to Mexico following its membership in NAFTA highlights the importance of this credibility effect for the Mexican economy.
CONCLUSION AND OUTLOOK

While reaping the short-term credibility effects stemming from international economic integration Mexico simultaneously embarked on a strategy of national institutional reform. The case study shows that the internal process of political reform and democratization is interwoven with the project of economic liberalization. The growing importance of opposition parties and growing citizen participation had important implications for the institutional environment of doing business in Mexico. Better control and higher checks and balances in the Mexican political system reduce the potential for the abuse of public power and the scope of nepotism that dominated in Mexico during the PRI governance. Reform of the judiciary allows for better contract enforcement and bureaucratic reform permits a more efficient provision of basic public services. A freer press and more societal controls will limit the blatantly high levels of corruption. Although still on a low level, the protection of individual citizens and businessmen against arbitrary and predatory government intervention increased. Hence, the dismantling of the semi-authoritarian PRI government did not only have political consequences but also positively influenced the business environment and investment incentives of national and international investors. Therefore, it may be argued that in Mexico the processes of democratization, institutional and economic reform are interdependent in the sense that progresses in either of these policy fields also have positive side effects on the other processes.

Despite of these initial successes, as theory predicts, the process of institutional reform is lengthy and results take a long time to materialize. For Mexico and other Latin American countries the results of this analysis highlight the importance of an institutional reform that allows for better governance and public administration. Second generation reforms that aim at strengthening the institutional environment would allow for completely reaping the benefits from better functioning markets while simultaneously attracting more foreign capital. Thus, Mexico as well as other Latin American countries, have to continue the process of reform by focusing on the amelioration of national institutions that permit a better functioning of markets. However, recent events in Latin America are not provoking a particularly optimistic outlook for the years to come. The serious economic and political crisis in Argentina, the populist Chavez regime in Venezuela, civil strife in Bolivia and the stagnating process of political reform in Mexico due to the deadlock in government indicate that still important societal resistance has to be overcome to successfully implement institutional reforms.