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Haiti's Political Turmoil: An Examination of its Implications on Foreign Direct Investment

Haiti'nin Siyasi Çalkantısı: Doğrudan Yabancı Yatırım Üzerindeki Etkilerinin İncelenmesi

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ABSTRACT

Haiti is a country with a history of political instability and faces considerable challenges in attracting foreign direct investment (FDI). This study investigates the impact of political turmoil on FDI in Haiti from 1994 to 2020. The study relies on secondary data obtained from sources such as International Financial Statistics (IFS), World Development Indicators(WDI), and the International Country Risk Guide (ICRG). The study utilizes the Vector Error Correction Model (VECM) and the Dynamic Ordinary Least Squares (DOLS) statistical technique. The findings indicate that, over the long run, political instability and inflation have an adverse influence on FDI in Haiti. Conversely, exchange rate, interest rate, and trade openness positively affect FDI. However, these variables do not directly drive FDI in the short term but are influenced by external factors. This paper emphasizes the critical role of establishing a stable political environment, effectively managing inflation, and maintaining competitive exchange rates and interest rates to enhance FDI attraction. Additionally, promoting trade openness is deemed crucial.

Anahtar Kelimeler :

Siyasi İstikrarsızlık,

Doğrudan Yabancı Yatırım,

Haiti

Jel Kodları:

D72, F21, F59

ÖZET

Haiti, siyasi istikrarsızlık geçmişine sahip ve doğrudan yabancı yatırım (FDI) çekme konusunda önemli zorluklarla karşı karşıya olan bir ülkedir. Bu çalışma, 1994-2020 yılları arasında Haiti'deki siyasi çalkantının FDI üzerindeki etkisini incelemektedir. Çalışma, Uluslararası Finans İstatistikleri (IFS), Dünya Kalkınma Göstergeleri (WDI) ve Uluslararası Ülke Risk Rehberi (ICRG) kaynaklardan elde edilen ikincil verilere dayanmaktadır. Çalışma, Vektör Hata Düzeltme Modeli (VECM) ve Dynamic Ordinary Least Squares (DOLS) istatistiksel tekniği kullanmaktadır. Bulgular, uzun vadede siyasi istikrarsızlık ve enflasyonun Haiti'deki FDI üzerinde olumsuz bir etkisi olduğunu göstermektedir. Bununla birlikte, döviz kuru, faiz oranı ve ticaret açıklığı FDI'yi olumlu etkiler. Ancak bu değişkenler kısa vadede doğrudan yabancı yatırımları yönlendirmemekte, dış faktörlerden etkilenmektedir. Bu çalışma, doğrudan yabancı yatırım çekiciliğini artırmak için istikrarlı bir siyasi ortam oluşturmanın, enflasyonu etkili bir şekilde yönetmenin ve rekabetçi döviz ve faiz oranlarını sürdürmenin kritik rolünü vurgulamaktadır. Ayrıca, ticari açıklığın teşvik edilmesinin de önemli olduğu değerlendirilmektedir.

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1. INTRODUCTION

Haiti is the first independent nation in the Caribbean, and has a long history of political instability. Following its independence in 1804, the nation witnessed a series of events including assassinations, external intervention, and the overthrow of democratically elected leaders. The most extended period of stability was experienced during the Duvalier dictatorship from 1957 to 1986. After the fall of the Duvalier regime, Haiti embarked on a journey toward democracy. Amendments were made to the constitution to establish autonomous entities tasked with safeguarding the division of authority. Yet, the outcome of this separation of powers fell short of expectations. This state of political instability slows down the country's economic growth and discourages foreign investors.

Haiti's self-generated economic resources are insufficient for sustained growth, necessitating foreign direct investment (FDI) to complement local investments and achieve its economic objectives. FDI can help to boost its economic growth by bringing in new technologies, creating jobs, and improving managerial skills and human capital. FDI can also create job opportunities, which leads to higher economic growth. In developing countries, FDI has been shown to increase productivity and make manufacturers more competitive (Yousaf et al., 2008). However, Haiti is constantly struggling with political instability, which discourages FDI. As illustrated in Figure 1 despite reaching a peak in 2017, FDI inflows have consistently dwindled over the subsequent three years. Foreign and domestic businesses are cautious about investing in Haiti due to the volatile political environment.

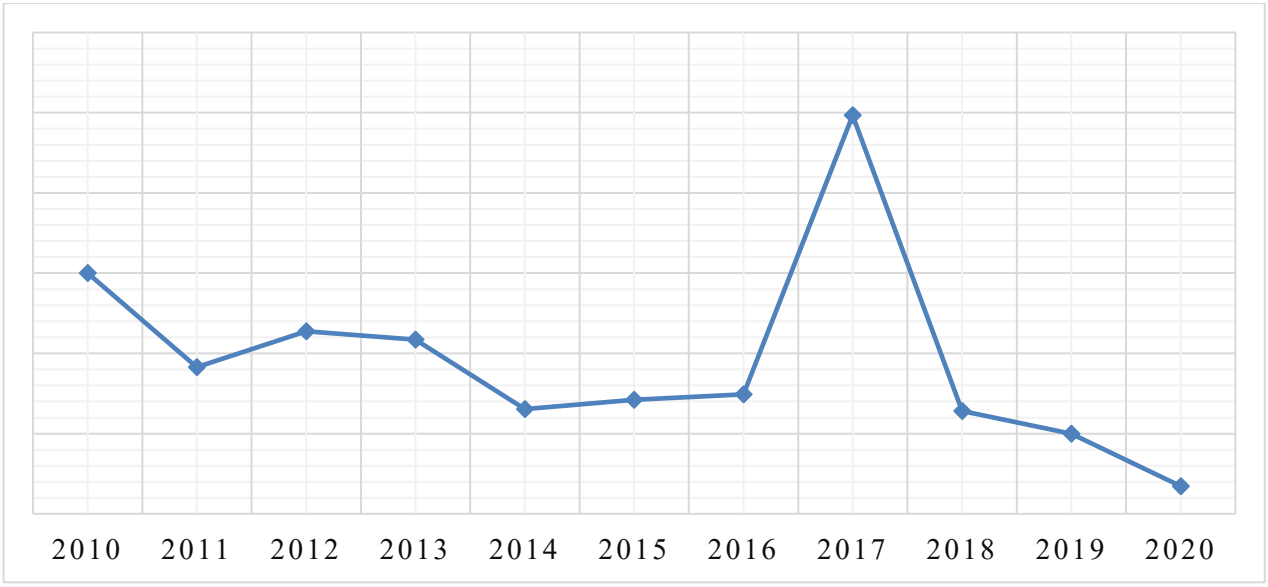

Figure 1. Foreign Direct Investments in Haiti (2010-2020)
Source: Prepared by the authors (Data from WDI, 2023)

Foreign investors prioritize the stability of a country's institutions when evaluating the potential returns on their investments. Their decision-making process is primarily influenced by the political climate of a nation. When faced with an unstable environment, investors become apprehensive about risking their capital, which they have earned through considerable effort. In essence, political instability diminishes the confidence of foreign investors and lowers their expectations regarding the profitability of their investments (Brada et al., 2003).

This study aims to bridge the existing gaps in the literature by providing novel quantitative assessments of the influence of political instability on FDI, with a specific focus on Haiti. The study employs the Vector Error Correction Model (VECM) and the Dynamic Ordinary Least Squares (DOLS) technique to analyze this relationship. This study makes a valuable addition to the empirical literature concerning the effects of political unrest on FDI in the context of Haiti. It becomes evident that the flow of FDI in Haiti is closely connected to periods of political instability. Such political turbulence exerts an adverse impact on foreign investments, reflecting a lack of confidence among potential international investors. Additionally, this study underlines the significance of factors such as interest rate, trade openness, and exchange rate as substantial contributors to FDI in Haiti.

The structure of this paper is outlined as follows. Section 2 presents a review of the relevant literature that has guided this research. Section 3 describes the data, methodology, and model specifications used in the study. Section 4 elaborates on the empirical findings, while Section 5 concludes with a discussion of the policy implications.

2. LITERATURE REVIEW

Many studies have shown that countries characterized by stable political systems tend to be more appealing to FDI. Brada et al. (2003) found that political instability caused by both domestic and international conflicts has a negative impact on FDI inflows in Central Europe and the Balkan region. However, they also found that political reforms have a positive impact on FDI inflows in these regions. Bakari et al. (2013); Bouchoucha & Ben Ammou (2015); Bokhari et al. (2021) have provided empirical evidence highlighting the significance of political instability in influencing the levels of FDI inflows in developing nations.

Busse & Hefeker (2007) applied Ordinary Least Squares (OLS), fixed effects, and the Generalized Method of Moments (GMM) in their analysis of 83 developing countries spanning the years 1984-2003. They conducted regressions by introducing each factor from the 12 components of the International Country Risk Guide (ICRG) along with other control variables to examine their impact on FDI. Their findings suggest that political risk and institutional indicators are not only highly significant in relation to FDI but also play a crucial role in influencing the investment decisions of multinational corporations.

Sekkat & Veganzones-Varoudakis (2007) addressed the comprehensive investment environment within a country, including location advantages in the OLI[1] paradigm. This includes infrastructure endowment, economic conditions, and the political environment. They examined the impact on both total FDI flows and FDI specifically in manufacturing, utilizing a panel data econometric regression model with fixed and random effects for the period 1990-1999. The total FDI sample comprised 72 developing countries, while the FDI in the manufacturing sample was limited to 20 observations due to data constraints. The results for total FDI indicated that market size, openness, infrastructure, economic risk, and political risk are significant and positively correlated with FDI.

Karifa-Schneider et al. (2010) discovered a positive link between reduced levels of political risk and an increase in FDI inflows across 33 developing and emerging nations. This implies that countries characterized by lower political risk tend to attract greater amounts of FDI.

Slangen & Beugelsdijk (2010) investigated the impact of institutional hazards on vertical and horizontal FDI. They tested their hypotheses within a contingency framework using data on aggregate sales of goods by US foreign affiliates across different host countries for the period 1996-2004. They applied generalized least squares regression, seemingly unrelated regression, and Heckman's two-stage analysis. The findings reveal that institutional hazards exhibit a statistically significant adverse effect on vertical FDI. Furthermore, governance deficiencies have a more substantial and significant impact compared to cultural distance on both forms of FDI.

Baek & Qian (2011) discovered that political risks exert varying impacts on the influx of FDI in developed and developing countries. They also identified that both developed and developing countries are drawn to FDI when they exhibit substantial levels of democracy and possess an appealing investment climate as shared political attributes.

In a study conducted by Vadlamannati (2012), micro-level data concerning U.S. multinational corporations investing in 101 developing countries was utilized to investigate how political instability affects U.S. foreign investments. The research revealed that a reduced level of political risk in the host country correlates with increased FDI by U.S. multinational companies and a higher rate of return.

Morrissey & Udomkerdmongkol (2012) conducted a study examining the connection between FDI and domestic private investment across 46 developing nations from 1996 to 2009. Their findings indicated that countries with stronger governance structures tend to be more attractive to both FDI and domestic private investment. The study also revealed that political instability and corruption exerted a noteworthy adverse influence on investment. In essence, the authors established that governance directly affects both private investment and FDI.

Hayakawa et al. (2013) employed the risk indices from ICRG to investigate the impact of a combination of political and financial risk components on FDI inflows from 1985 to 2007. Their study included a sample of 93 countries, consisting of developed and developing nations, with a particular emphasis on the latter. They utilized fixed effects models and dynamic GMM methodology for their regression analyses. Their key finding indicated that political risk serves as a robust determinant of FDI. Among the 12 ICRG components examined, socioeconomic conditions, internal and external conflict, government stability, religious tensions, corruption, investment profile, ethnic tensions, and democratic accountability emerged as significant determinants of FDI

[1] The OLI framework is a theoretical model that elucidates the reasons behind firms' decisions to invest in foreign countries. This model revolves around three primary components: ownership advantages, location advantages, and internalization advantages. Location advantages encompass the attributes that render a country appealing for foreign investments, including aspects like market size, infrastructure, and political stability.

flows. Particularly, investment profile, external conflict, and socioeconomic conditions were identified as the most influential components.

Al-Khouri & Abdul Khalik (2013) investigated the impact of political risk on FDI net inflows in the MENA region. When considering all countries, the findings revealed a negative association between political risk and FDI. Specifically, among the 12 political risk indicators examined, corruption and external conflict demonstrated a statistically significant adverse correlation with FDI. In contrast, less democracy and greater socioeconomic pressures exhibited statistically significant positive relationships with FDI.

Burger et al., (2013) examined how the Arab Spring influenced the performance of various economic sectors in the Middle East and North Africa (MENA) area. Employing OLS estimation with data concerning greenfield investments in MENA nations, they found a negative association between the Arab Spring and investments in the manufacturing sector.

Khan & Akbar (2013) explored the correlation between political risk and FDI by focusing on individual political risk factors. They conducted their analysis using panel data from 94 countries spanning the period 1986-2009. Their investigation included specific categories such as lower middle-income, upper middle-income, low-income, and high-income countries. Their study suggested that countries must address and minimize political risk and uncertainty. These factors were identified as exerting a negative impact on FDI.

Goswami & Haider (2014) explored how governance failure, cultural conflict, and partner attitudes impact FDI inflows in both developing and developed nations. They uncovered that cultural conflict and partner attitudes play significant roles in impeding FDI inflows, while intriguingly, under the fixed effect assumption, governance failure appeared to encourage FDI.

Bouyahiaoui & Hammache (2013) conducted a statistical analysis to assess the impact of the Arab Spring on FDI in the MENA region. Their study revealed that the considerable political upheavals in nations such as Egypt, Tunisia, Libya, and Yemen, along with the ongoing political instability in Mediterranean countries like Iraq, Iran, and Bahrain, constitute substantial obstacles that hinder the flow of FDI into the MENA region.

Hira (2017) investigates the impact of political uncertainty on the behavior of corporate investors in Pakistan. The author utilized stock prices as a gauge for assessing political uncertainty and accessed data from the Yahoo Finance index pertaining to the Pakistan stock market during the period spanning 1998 to 2012. The analytical method employed was the ARDL model, which was used to scrutinize the connection between political instability and the stock market index. The outcomes of the study revealed a negative correlation between political instability and stock prices, signifying that an unstable political environment tends to coincide with reduced stock prices. Furthermore, the study also indicated positive associations between stock prices and both exports and industrial production, while showing a negative relationship with inflation.

Kurecic & Kokotovic (2017) investigated the relationship between political instability and FDI in small and large economies. Employing the Granger Causality test and Vector Autoregressive (VAR) methods, they identified an adverse influence of political instability on FDI inflow, particularly in small economies. In contrast, no such clear connection was observed for larger economies.

Bitar et al. (2019) focused on Lebanon to explore the relationship between political risk and FDI. They utilized 12 political risk indicators from the ICRG, which were organized into three categories following the resolution of overlap issues, to examine data spanning from 2008 to 2018. The results offer proof of significant causality between all factors related to political risk and FDI inflow.

Tung & Thang (2020) delved into the connection between FDI and domestic private investment within 49 developing nations across Asia and Africa. Their findings revealed that FDI serves to complement private investment, indicating that FDI tends to stimulate an increase in private investment. The research also highlighted that previous private investment plays a vital role in predicting future private investment. Furthermore, the authors noted that trade openness, per capita GDP, and electricity availability all exert a positive influence on private investment.

3. METHODOLOGY

Numerous economic theories shed light on the motivations behind foreign companies opting to invest in other countries. One widely accepted theory is the neoclassical perspective, which argues that FDI has a positive impact on a country's economic progress. This is because FDI brings in fresh capital, advanced technology, and

employment opportunities to the recipient country. It stimulates local enterprises to increase their investments and enhance their productivity. Aside from fostering economic development, FDI can contribute to the accumulation of capital within the host country. This translates to an increased pool of resources available for investment, thereby potentially bolstering economic growth.

In this study, we have constructed a comprehensive model for FDI inflows, drawing from prior studies. The factors we have incorporated into our model are expected to have an impact on FDI inflows, as they are frequently cited as significant factors influencing investment location within the OLI framework (Vernon, 1966; Rugman, 1981; Dunning, 2000). The factors that we have included in our model are political instability, trade openness, interest rates, exchange rates, inflation rates, and real GDP.

Our approach to examine the influence of political instability on FDI inflows in Haiti shares similarities with the models employed by Oladipo et al., (2007), Bhatti et al., (2008); Del Bo (2009); Mádr & Kouba (2015). The model we will employ to investigate the effects of political instability on FDI inflows is outlined as follows:

$$FDI_t = \beta_0 + \beta_1 PI_t + \beta_2 TO_t + \beta_3\, GDP_t + \beta_4 IRt + \beta_5 INFt + \beta_6 ER + \mu_t \quad (1)$$

Table 1 presents the data employed in our study, their representation, their description, and the data sources.

Table 1. Data Description

Variables	SIGN	Description of the variables	Source
Foreign Direct Investment	FDI	Denotes the percentage of annual inflows.	WDI
Political Instability	PI	Political Risk index	ICRG
Trade Openness	TO	The combined value of exports and imports as the percentage of GDP	WDI
Interest Rate	IR	Interest rate (Lending rate)	IFS
Real GDP	GDP	GDP per capita, PPP (constant 2017 international $)	WDI
Inflation	INF	Consumer Price Index (CPI)	WDI
Exhange Rate	ER	Domestic Currency Per US Dollar)	IFS

Figure 2 illustrates the temporal evolution of the data utilized in our study. This can be beneficial for comprehending the study's findings and for making inferences. It can also help in identifying potential correlations between the variables and, if such correlations exist, understanding their direction.

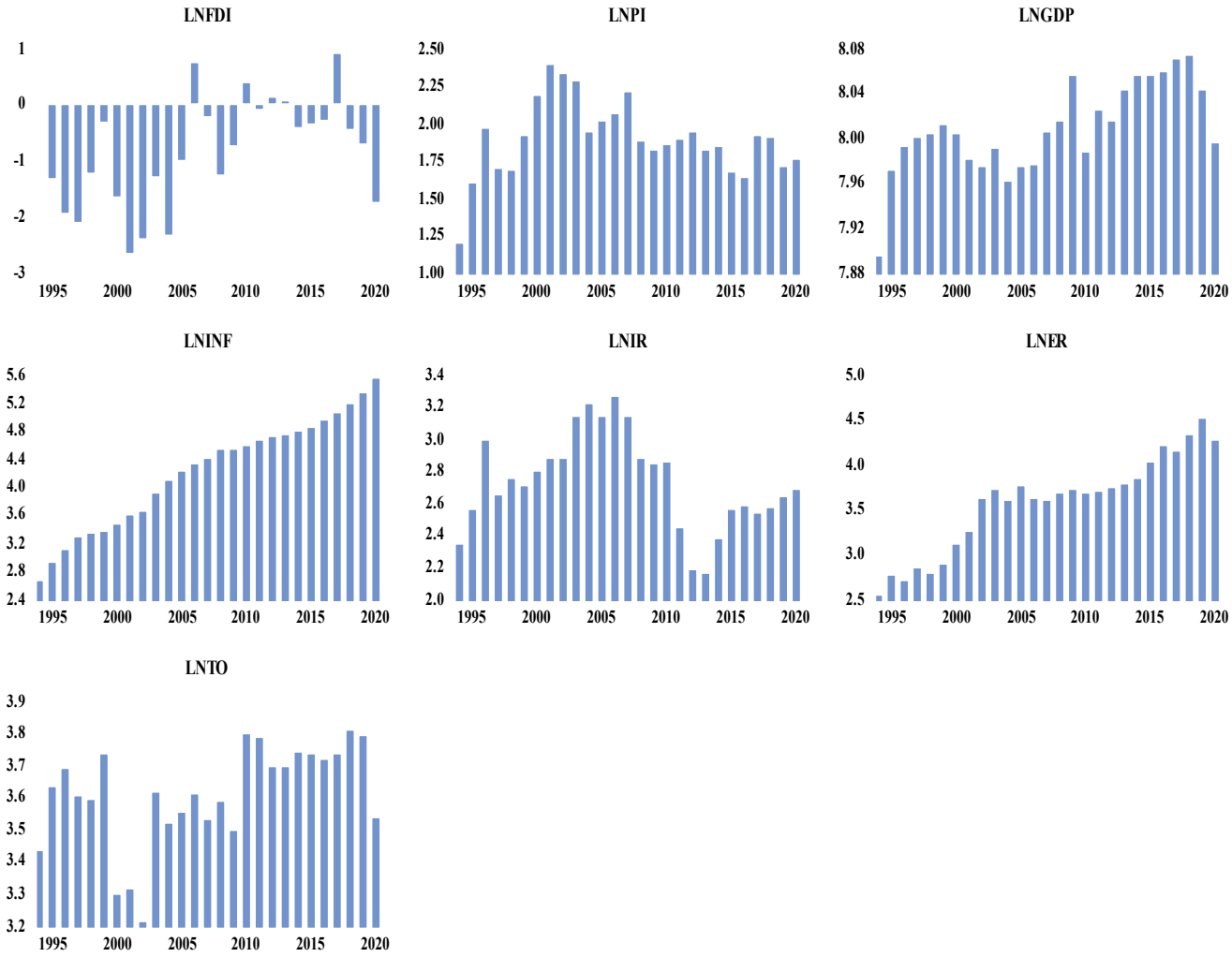

Figure 2. Time Series Plots of the Logarithmic Form of Variables

Table 2 presents the outcomes of the first step in our statistical analysis, which is a descriptive examination. One observes that the mean statistic of real GDP is higher than that of all other variables, and the mean, minimum, and maximum values of lnPI, lnER, lnIR, lnTO, and lnINF are relatively close to each other.

Table 2. Descriptive Statistics

Variables	Mean	Standard Dev.	Minimum	Maximum
lnFDI	-0.8571	0.9835	-2.6665	0.9097
lnPI	1.8966	0.2524	1.2039	2.3978
lnER	3.5818	0.5376	2.5608	4.5216
lnGDP	8.0093	0.0401	7.8953	8.0738
lnIR	2.7374	0.2998	2.1659	3.2721
lnTO	3.6126	0.1575	3.2164	3.8097
lnINF	4.2304	0.7873	2.6858	5.5658

After the data summarization and description, we applied statistical models to assess unit roots and cointegration. Unit root testing is employed to establish whether a time series is stationary, signifying that its mean and variance remain constant over time. Cointegration testing is utilized to ascertain if two or more time series exhibit a shared movement over time. The study follows the augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests to test the unit root. Once stationarity is confirmed, the Johansen cointegration test is applied to assess cointegration (Johansen, 1988, 1990).

4. EMPIRICAL FINDINGS

Table 3 displays the outcomes of the unit root tests. The Augmented Dickey-Fuller and Phillip Perron unit root test statistics yield varying results regarding the null hypotheses for the series at their original levels. However, both test statistics indicate that the first-differenced versions of the series exhibit stationarity. Consequently, it can be inferred that the series are integrated of the first order [I(1)].

Table 3. Unit Root Tests

Test Statistic	**Augmented Dickey Fuller(ADF)**		**Phillips-Perron(PP)**	
Times series	Level	1st difference	Level	1st difference
lnFDI	-2.7514 (0.2264)	-5.3215* (0.0014)	-2.5788 (0.2918)	-8.7600* (0.0000)
lnPI	-3.0722 (0.1341)	-4.6767* (0.0051	-3.7985** (0.0331)	-5.0978* (0.0020)
lnER	-2.6740 (0.2549)	-4.6920* (0.0050)	-2.0611 (0.5422)	-4.6920* (0.0050)
lnGDP	-3.3585 (0.0792)	-6.1085* (0.0002)	-3.5350*** (0.0563)	-6.1701* (0.0002)
lnIR	-2.2316 (0.4530)	-4.3615** (0.0103)	-2.3886 (0.3763)	-4.3426** (0.0107)
lnTO	-3.1877 (0.1087)	-6.3476* (0.0001)	-3.2043 (0.1054)	-6.7670* (0.0000)
lnINF	0.0463 (0.9545)	-3.0823** (0.0410)	-1.2525 (0.6355)	-3.0823** (0.0410)

With *,**,*** illustrate 1%, 5%, and 10% statistical significance respectively.

Table 4 depicts the results of the Johansen cointegration test and shows that there is statistically significant cointegrating relationship between the variables in the model at the 0.05 significance level. The Trace test indicates that there are 3 cointegrating equations, while the Max-Eigen test shows that there are at least 2 cointegrating equations. Given the cointegration of the variables, employing the VECM is a suitable approach for examining both the short-term dynamics and long-term equilibrium of these variables.

Table 4. Cointegration Tests

Hypothesized No. of CE(s)	**Trace Statistic**	**0.05 Critical Value**	**Prob.****
None *	170.6365	95.7536	0.0000
At most 1 *	99.1598	69.8188	0.0000
At most 2 *	52.5379	47.8561	0.0170
At most 3	27.0771	29.7970	0.0998
Hypothesized No. of CE(s)	**Max-Eigen Statistic**	**0.05 Critical Value**	**Prob.****
None *	71.4767	40.0775	0.0000
At most 1*	46.6218	33.8768	0.0009
At most 2	25.4607	27.5843	0.0912
At most 3	16.3448	21.1316	0.2054

Once the cointegrating equations are determined, we normalize them with respect to the FDI variable and choose the most suitable one that accurately captures the relationship between the variables. The VECM outcomes are showcased in tables 5 and 6. Based on these results, we draw the following conclusions regarding Haiti:

In the short run, the variables of political instability, gross domestic product, trade openness, exchange rate, and interest rate are considered exogenous. This indicates that these variables are not drivers of FDI; instead, they are influenced by external factors not considered in the model.

Over the long run, political instability and inflation are both statistically significant and exert a detrimental effect on FDI. This implies that an increase in political instability or inflation leads to a reduction in FDI. Additionally,

exchange rate, interest rate, and trade openness are also statistically significant and positively influence FDI. Consequently, when the exchange rate, interest rate, or trade openness decreases, FDI experiences an increase.

The significant adjustment term at a 5% level suggests that discrepancies from the long-term equilibrium are rectified at a rate of 8.162%.

Table 5. Long-run Estimates

lnFDI	Coefficient	Std. Err.	z	p-value
lnPI	-0.8173**	0.3285	2.49	0.013
lnGDP	-1.6787	1.7653	0.95	0.342
lnER	5.6216*	0.3611	-15.56	0.000
lnIR	0.87496*	0.1232	-7.10	0.000
lnINF	-3.6670*	0.2815	13.02	0.000
lnTO	5.5423*	0.4404	-12.58	0.000

Note: *,** illustrate 1% and 5%, statistical significance respectively.

Table 6. Short-run Estimates

lnFDI	Coefficient	Std. Err.	z	p-value
ECT	0.8162*	0.3077	-2.65	0.008
lnPI	1.1064	1.1321	-0.98	0.328
lnGDP	-6.6991	7.3323	0.91	0.361
lnER	2.8718	2.0217	-1.42	0.155
lnIR	1.4642	1.1666	-1.26	0.209
lnINF	10.1643**	4.8785	-2.08	0.037
lnTO	2.4219	1.4426	-1.68	0.093

Note: *,** illustrate 1% and 5%, statistical significance respectively.

Considering the long-term dynamics among the variables, the DOLS technique was employed to calculate long-term coefficients. In Table 7, the outcomes of the DOLS reveal that over the long run, political instability and inflation adversely affect FDI. In contrast, a positive correlation is observed between FDI and exchange rate, interest rate, and trade openness. Overall, based on these results, it is reasonable to affirm that political instability significantly discourages FDI in Haiti, thereby hampering the country's prospects for economic development.

Table 7. DOLS Results (Dependent Variable: lnFDI)

	DOLS		
	Coefficient	**t-Statistic**	**p-value**
lnPI	-3.2709**	-3.3908	0.0147
lnGDP	-11.8106**	-3.0874	0.0215
lnIR	0.8633**	2.7257	0.0344
lnER	9.2148*	7.3089	0.0003
lnINF	-6.1365*	-6.6795	0.0005
lnTO	5.6283*	4.0975	0.0064

Note: *,** illustrate 1% and 5%, statistical significance respectively.

5. CONCLUSION

This study explores the influence of political instability on the FDI dynamics in Haiti from 1994 to 2020. The results of the study indicate that in the long term, political instability and inflation negatively affect FDI. Conversely, exchange rates, interest rates, and trade openness exhibit statistical significance and positively impact FDI in Haiti. In the short term, these variables do not act as FDI catalysts; rather, they are influenced by external factors that were not considered in the model.

Based on the findings of this study, to enhance foreign investment inflows, Haiti should prioritize establishing a stable political climate, managing inflation effectively, and ensuring competitive exchange rates and interest rates. Furthermore, efforts to promote trade openness should also be a focal point for Haiti. The results align with prior research, including studies by Brada et al. (2003); Busse & Hefeker (2007); Bokhari et al. (2021), which similarly assert that political instability results in reduced FDI. Countries with political instability and high inflation rates tend to have diminished appeal for foreign investors. This diminished attractiveness arises from the inherent risks posed to investors and the challenges they encounter in realizing profits. On the other hand, countries characterized by political stability, low inflation, a favorable exchange rate, and open economic policies are more inclined to entice foreign investments.

The paper suggests that Haiti needs to address its political instability in order to attract more FDI and promote economic growth. The government can do this by adopting long-term policies that will strengthen institutions, reduce corruption, and promote peace and stability.

In future research, it is advisable to take into account the particular industry or sector when examining the connection between political factors and FDI. For instance, certain industries, like the financial sector, can be significantly more susceptible to the effects of political instability compared to others. Future studies should also take into account elements such as market size and infrastructure. Countries with large markets and well-developed infrastructure are more inclined to appeal to foreign investors.

AUTHORS' DECLARATION

This paper complies with Research and Publication Ethics, has no conflict of interest to declare, and has received no financial support.

AUTHORS' CONTRIBUTIONS

Conceptualization, writing-original draft, editing – **PRLJ** and **SAK**, data collection, methodology, formal analysis – **PRLJ**, Final Approval and Accountability – **PRLJ** and **SAK**

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