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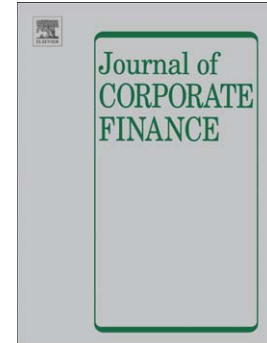
Politics, instability, and composition of international investment flows

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# Politics, instability, and composition of international investment flows

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## Abstract

We analyze the role of political instability for the composition of foreign investment, whether it takes the form of a majority- or minority-owned investment. We focus on the instability generated by the change of the party in power rather than on the risk of change of political regime or expropriation risk associated with this change. In majority-owned establishments, a foreign investor retains the control and enjoys fewer agency problems, while for minority-owned investments or joint ventures domestic partners of a foreign investor can lobby the government for preferential arrangements, such as firm-specific tax breaks. Political instability decreases the payoff of political connections in the future and decreases the attractiveness of minority-owned investments. The implications of our model are supported by empirical tests.

Keywords: Political Instability, Agency Problems, Investment Flows

JEL Classification: F10, G32

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