

Intimidated Investors? Host Market and Industry Characteristics Shape FDI's Reaction to Terror

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Abstract

Under what circumstances does terrorism repel foreign investment? The overall negative relationship between terrorism and foreign investment identified in current scholarship masks heterogeneity across both host markets and industries. Investment will be less responsive to terror when firms lack viable alternative markets; when host governments are more desirous of FDI; and when political institutions generate certainty. We formally model the endogenous co-determination of terror and investment to derive these comparative statics and to highlight several empirical challenges in identifying the effects of terror on FDI. To overcome these challenges, we develop an instrumental variable estimator which exploits differences in the networks along which terror and investment spread. We test our model using industry-level data on the activities of US multinationals, and conclude with implications for the strategic interaction of investors and terror groups.

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