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Analyzing the Impact of Cultural Distance on U.S. FDI Activity in the Global Economy

Research Objective

As the most active foreign direct investment (FDI) participating nation in the world, the U.S. had a total of $246 billion FDI inflow and $125 billion FDI outflow in 2019, making the U.S. the largest recipient and the 2nd largest sourcing nation of the global FDI activities in the world. Over the years from 2010 to 2019, the outbound FDI activities from the U.S. had increased by 56% from $3.74 billion to $5.83 billion. This project investigates the outbound FDI activities of the U.S. in other nations around the world using data from 2010, 2015, and 2019, and it analyzes the role played by cultural similarities/differences between the U.S. and the investment destination in attracting or deterring the FDI from the U.S.

Data Sources

THE WORLD BANK

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

Hofstede Insights

WORLD ECONOMIC FORUM

BEA
BUREAU OF ECONOMIC ANALYSIS
U.S. DEPARTMENT OF COMMERCE

TRANSPARENCY INTERNATIONAL
the global coalition against corruption

- PPP-adjusted GDP (in constant 2017 USD) and population data is collected. Supplemental data is collected from St. Louis Federal Bank for Taiwan and Venezuela.

- Geert Hofstede's cultural characteristics are collected for 54 of 57 countries in the FDI nation sample.

- Global competitiveness index (GCI) is collected for all the sample countries based on the report in 2010, 2015 and 2019.

- U.S. FDI Position Abroad data is collected for 57 countries in 2015. These countries account for more than 95% of the total FDI position abroad in the year concerned.

- Corruption Perception Index (CPI) is collected for all the sample countries.

Variable Development and Estimation Model

$$Cultural\ Distance\ of\ Nation\ j\ from\ the\ US = \frac{Cultural\ Score\ of\ Nation\ j}{Cultural\ Score\ of\ the\ US}$$

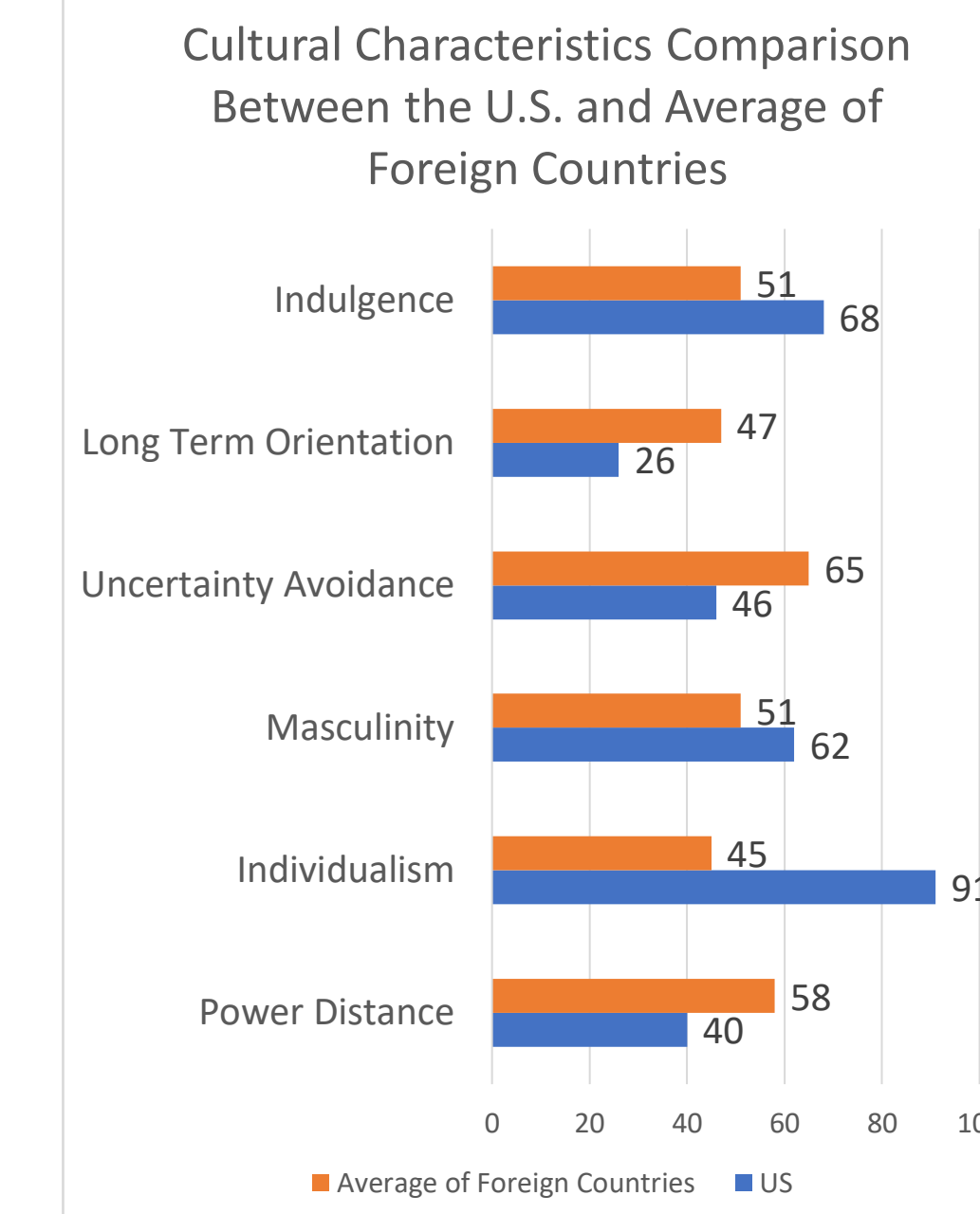$$FDI\ Distance\ of\ Nation\ j\ from\ the\ US = 1 - ln\left(\frac{FDI\ from\ the\ US\ in\ Nation\ j}{Total\ FDI\ Abroad\ Position\ of\ the\ US}\right)$$

$$FDI\ Distance_j = \alpha_0 + \alpha_1 \times ln(GDP_j) + \alpha_2 \times ln(GCI_j) + \alpha_3 \times Cultural\ Characteristics_j + \varepsilon$$
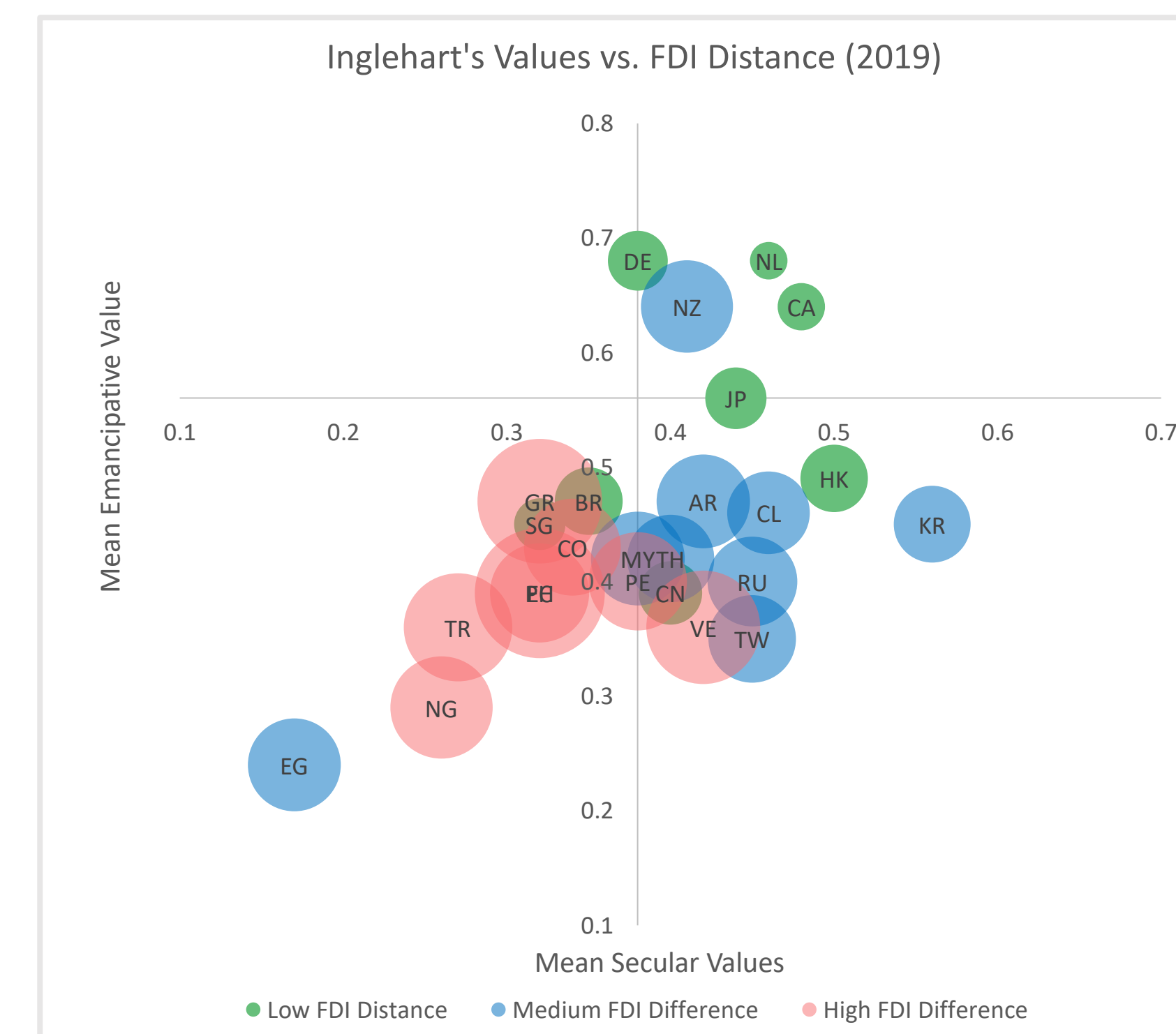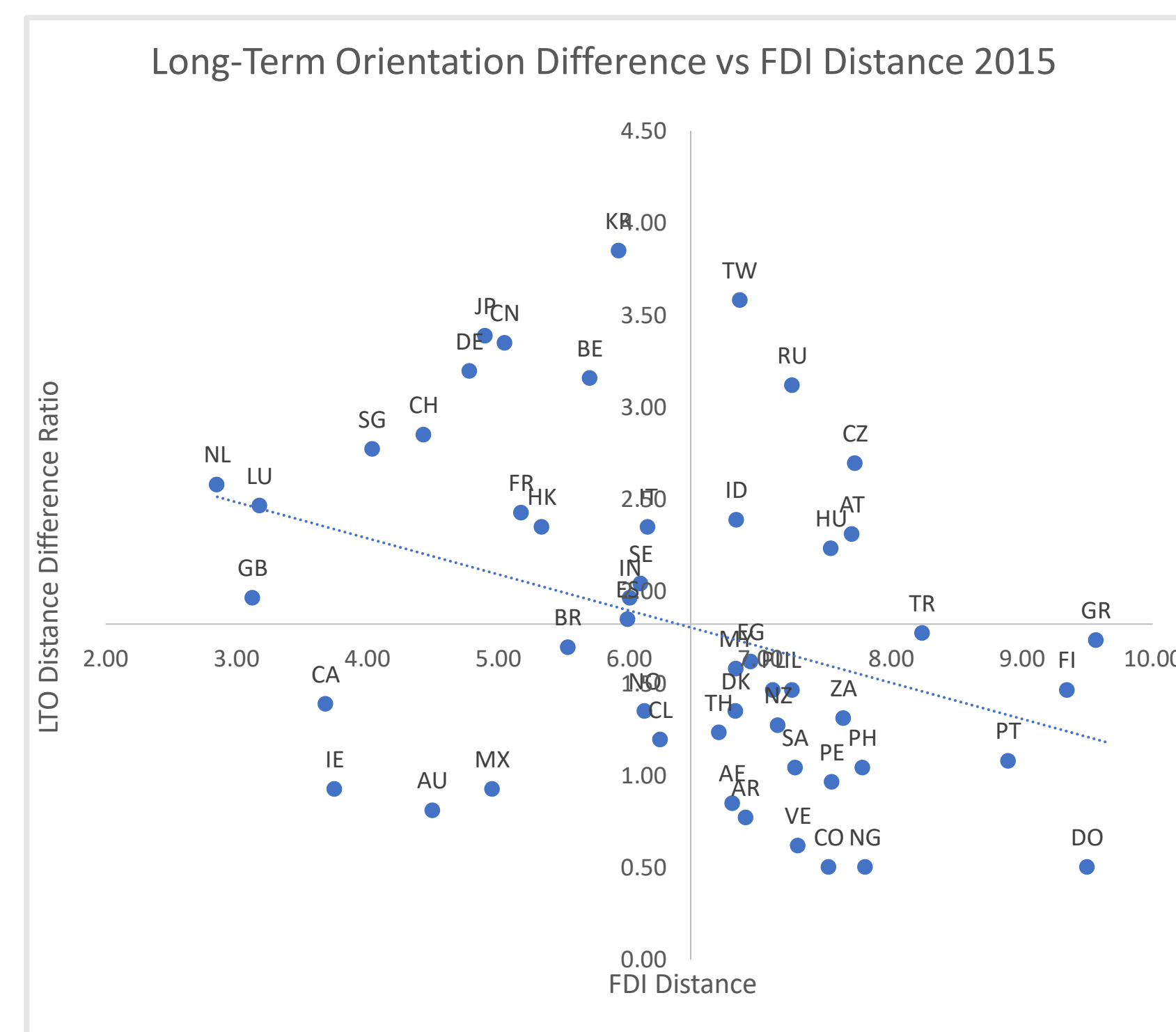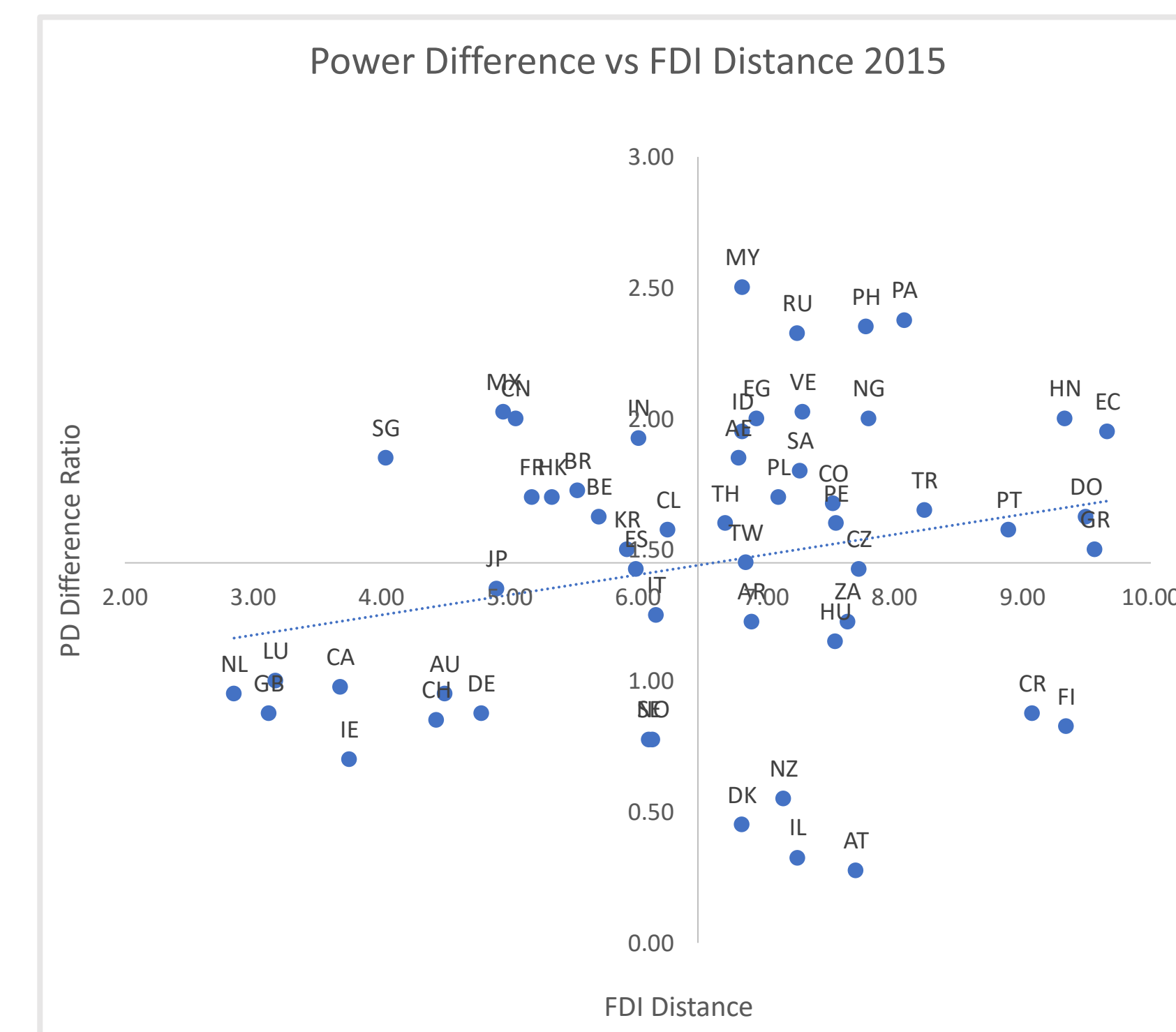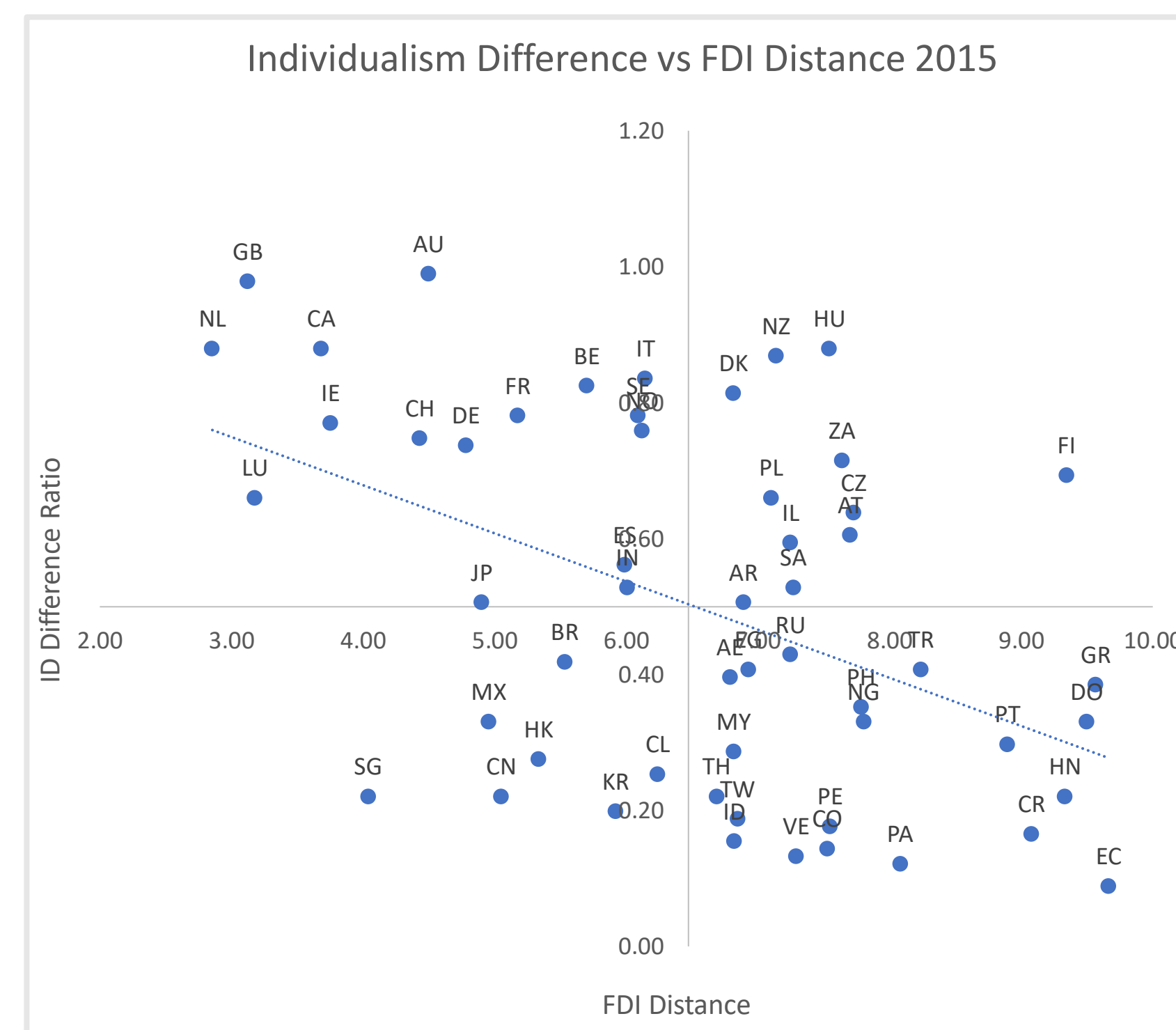
Results

Ordinary Least Square (OLS) Estimation Results

Variables	FDI Distance in 2010	FDI Distance in 2015		FDI Distance in 2019		
Ln(GDP$_t$)	-0.483*** (0.002)	-0.464*** (0.007)	-0.390*** (0.009)	-0.437*** (0.008)	-0.341** (0.017)	-0.343** (0.017)
Ln(GCI$_t$)	-6.545*** (0.000)	-6.916*** (0.000)	-5.076*** (0.002)	-6.731*** (0.000)	-5.099*** (0.001)	-5.936*** (0.000)
Indulgence	-0.0287*** (0.002)	-0.0289*** (0.005)		-0.0290*** (0.005)		
Individualism			-0.0164* (0.063)		-0.0166* (0.059)	
Uncertainty Avoidance						0.0145* (0.086)
Constant	48.34*** (0.000)	49.76*** (0.000)	39.29*** (0.000)	48.59*** (0.000)	38.32*** (0.000)	40.25*** (0.000)
Observations	48	48	54	48	54	54

Note: *p*-values in parentheses (* $p<0.10$, ** $p<0.05$, *** $p<0.01$)

Cultural Characteristics Comparison Between the U.S. and Average of Foreign Countries

Indulgence: 51 / 68
Long Term Orientation: 47 / 26
Uncertainty Avoidance: 65 / 46
Masculinity: 51 / 62
Individualism: 45 / 91
Power Distance: 40 / 58

■ Average of Foreign Countries ■ US

Overview of Cultural Values and FDI Distance

Individualism Difference vs FDI Distance 2015

Power Difference vs FDI Distance 2015

Long-Term Orientation Difference vs FDI Distance 2015

Inglehart's Values vs. FDI Distance (2019)

● Low FDI Distance ● Medium FDI Difference ● High FDI Difference

Inglehart-Welzel World Map

WVS, 2008
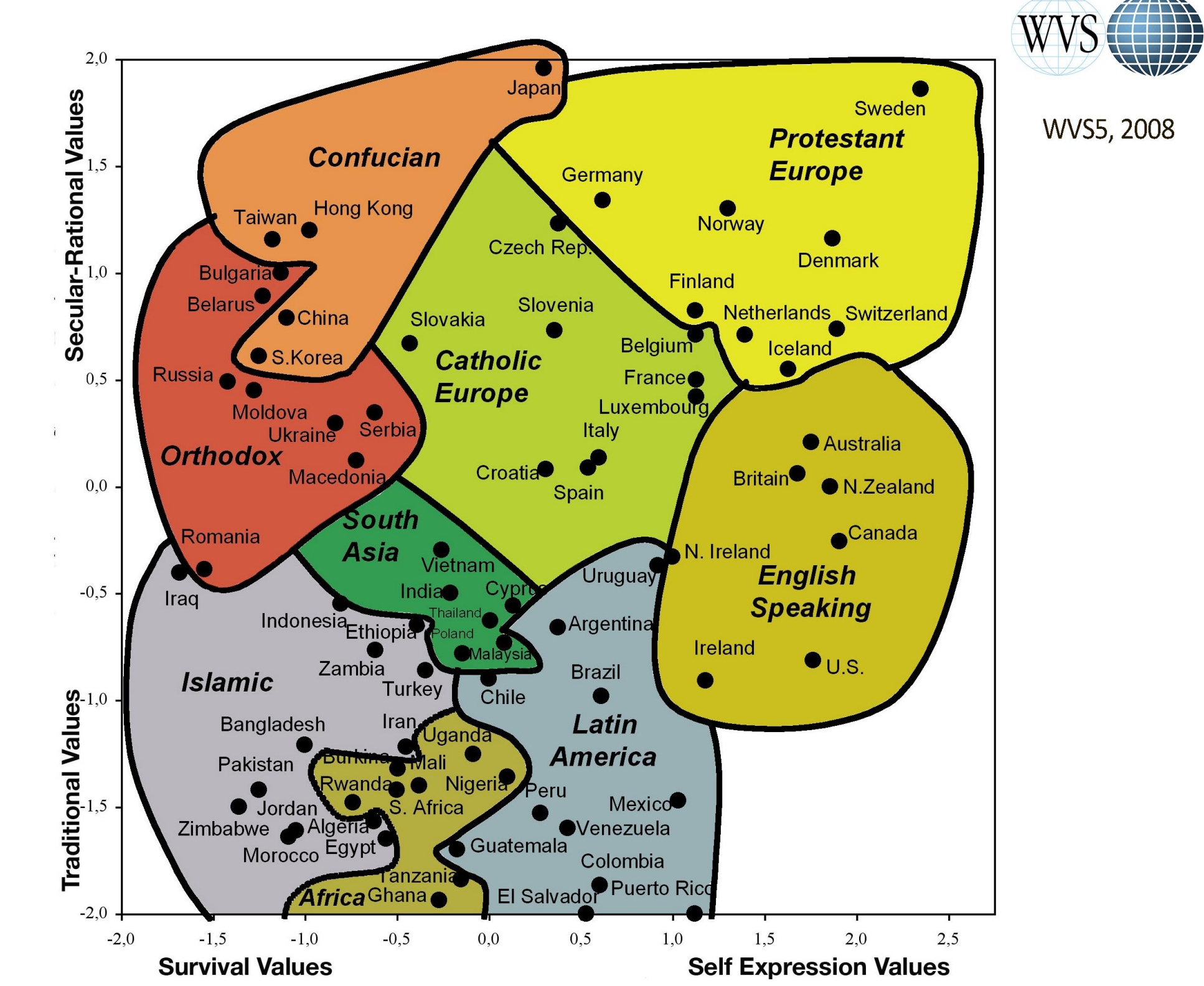
Less Corruption, Higher Global Competitiveness

GCI vs CPI in 2015
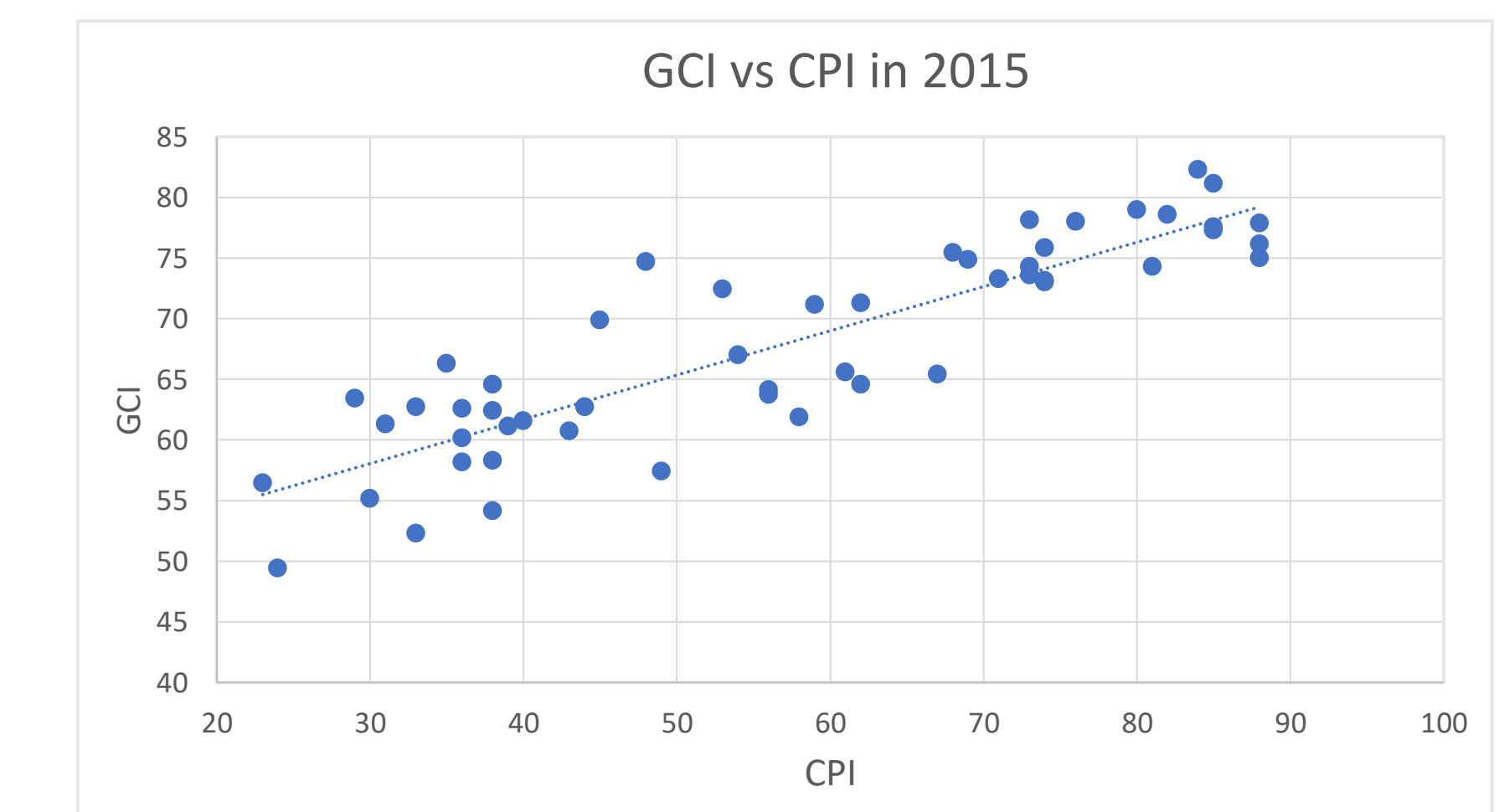
Conclusions

- Greater economic size and stronger overall competitiveness of a nation will attract the FDI from the U.S.
- After controlling for GDP and GCI, we find that FDI from the U.S. is not affected by power distance, masculinity, and long-term orientation, while high indulgence and high individualism are found to attract FDI from the U.S.
- High uncertainty avoidance is found to deter the FDI from the U.S. only in 2019, reflecting the growing global geopolitical uncertainty.
- The secularity and emancipation values of a nation are negatively correlated with its FDI distance from the U.S. at –0.46, and –0.58, respectively.
- Many underdeveloped nations have both lower secular and lower emancipation scores, and such cultural characteristics are those that evolve slowly as a society transforms from agriculture-focused to industrialization, and then to service economy.
- A better understanding of such cultural differences will be essential to help attract more FDI into developing nations for a more inclusive, balanced and sustained economic development and growth worldwide.