The Political Determinants of Investment Policy in Non-Democracies

Sarah Bauerle Danzman

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Abstract

What explains foreign direct investment (FDI) policy in autocratic regimes, given that such investments have distributive consequences? While FDI tends to benefit labor via job creation and higher wages, such investment tends to reduce returns to domestic capital. Premised on this stylized fact, an emerging research agenda has argued distributive politics can explain government openness to FDI and that democracies will be more open to such investments than autocracies since democracies are more beholden to labor interests than are autocracies (Pandya 2014, Dorobantu 2010, Pinto 2013). Yet, autocracies also vary in their openness to FDI and empirical work indicates that non-democracies often pursue incentives to attract investment that are more generous than their democratic counterparts (Li 2006). I argue institutional features of autocracy are systematically linked to autocratic regimes posture toward FDI. While conventional wisdom suggests autocracies are insulated from popular demands and instead focus on distributing rents among members of their ruling coalitions, I argue autocratic institutions vary in the extent to which rulers must consider mass interests. More specifically, I contend ruling party institutionalization and urbanization condition the effect of competitive elections on autocrats investment policies. I test my hypotheses on a dataset of foreign investment policy in 82 non-democratic countries from 2000-2011.

1 Policies Toward Foreign Investment - Framing the Issue

One of the most striking features of the contemporary international economy is the extent to which multinational production networks dominate. Data on intrafirm trade are limited, but suggest trade among subsidiaries accounts for over 50% of total international trade flows (Lanz and Miroudot 2011). Foreign direct investment (FDI) has increased 10-fold since the end of the Cold War, and now accounts for 9.2% of total world domestic capital formation, up from 4.2% in 1990 (UNCTAD 2012). The centrality of FDI is particularly evident in developing economies. FDI is now the single largest source of international capital to such countries, surpassing debt, official development assistance, portfolio investment, and remittances. The rise in FDI has occurred within the context of a broad macro trend of capital account liberalization and investment policies that extend national treatment to foreign firms and sometimes even privilege FDI over domestic capital through generous tax exemptions and preferential legal treatment (Kobrin 2005). Scholarship exploring government decisions to liberalize capital flows broadly and FDI particularly provide a variety of explanations at both the domestic and international level of analysis; democratization (Pandya 2014), partisanship (Brooks and Kurtz 2007), neoliberal norm creation (Chwieroth 2007), international institutional coercion (Brune, Garrett and Kogut 2004), and competitive diffusion (Brune, Garrett and Kogut 2004; Simmons, Dobbin and Garrett 2006) each may explain governments' decisions to liberalize. What is less well explained by extant literature is liberalization in authoritarian contexts. This project seeks to fill that gap in the literature, specifically in the context of FDI.

Why Study Policy?

Much of the literature on FDI focuses on its' supply. In other words, most empirical work models flows of FDI and considers how political institutions affect firm decision-making. Received wisdom holds that democracies are better able than non-democracies to attract investment because democratic institutions constrain leaders' ability to expropriate while autocrats face little institutional constraints on seizing private assets. There is some empirical evidence to support this claim. Jensen, Biglaiser, Li, Malesky, Pinto, Pinto and Staats (2012) finds democracies are less likely to expropriate assets than non-democracies, primarily because democracies have increased institutional veto points that constrain policymaking. Additionally, as figure 1 indicates, democracies have generally attracted more foreign direct investment (FDI) than non-democracies over the past 50 years. However, the substantive difference in average FDI inflows, though statistically significant, is just under one half of one percentage point of gross domestic product - not a very large democratic advantage. Non-democracies also display more variation in FDI inflows than democracies.

[Insert Figure 1 here]

Existing literature mostly concentrates on the institutional mechanisms through which governments can credibly commit to respecting private property rights of investors given time-inconsistent preferences. To the extent that the central claim that democracies are better able to attract FDI than non-democracies has been challenged, it has generally been by questioning the usefulness of three assumptions - 1) foreign investment has sufficiently high redeployment costs as to severely limit their bargaining position after investment (Kobrin 1987), 2) non-democracies are homogeneous in their lack of institutionalized constraints on executives (Jensen, Malesky and Weymouth 2011), 3) firms face homogenous preferences over risk-avoidance (CITE).

Surprisingly, there has been comparatively less attention on governments' preference formation over FDI. Implicit in the literature grounded in institutional solutions to the obsolescing bargain is an assumption that all governments seek to maximize investment inflows, but would also like to heavily tax or control it. However, this assumption may be wrong because foreign investment has important distributive consequences within society; inward FDI changes the relative demand for different factors of production. Thus, the domestic politics of FDI is theoretically similar to the domestic politics of trade. While the trade literature problematizes domestic support for trade openness, contemporary scholarship on FDI lags.

This research project looking explicitly at the demand for FDI, as measured by governments' policies related to allowing FDI inflows and incentivizing such investment. There are several reasons why studying policy rather than flows may be helpful. First, explaining policy allows me to more fully explore the preference aggregation process through which societies become open or closed to investment inflows. Second, FDI inflows are incredibly sticky. Lagged values of FDI flows explain almost 50% of current FDI flows. Regime type explains less than an additional 1% of flows. In other words, a firms' initial decision to invest matters a great deal for future FDI flows. To the extent that government policies can attract initial investment, these policies can have lasting implications for patterns of FDI flows. Finally, policy organizations have recently placed greater emphasis on "best practice" regulation of FDI. UNCTAD's 2012 World Investment Report devotes a lengthy section to combining long-term capital account liberalization with public interest regulation of foreign investment to give governments space to pursue national development policies (2012). Of course, regulatory regimes are subject to capture; study of the political determinants of FDI policies also contributes to increased recognition of when regulation is in the private rather the public interest and to better understanding of how capture occurs.

FDI Policy Within the Context of a Macro Trend Toward Liberalization

FDI liberalization reflects larger policy choices about capital account openness. Popular accounts of liberalizing policies reflect beliefs that ideological convergence toward neoliberal economic principles as well as technological innovations have made governments more sympathetic toward calls for capital account openness. Especially in the wake of the sovereign debt crises of the 1980s and the 1997 Asian financial crisis, governments and international institutions have emphasized the stabilizing effects of FDI. Direct investment is largely robust to crisis while portfolio flows are prone to "sudden stops," strongly pro-cyclical, and dangerous to capital account stability. In this context, liberalization is a technocratic and reflexive response to apolitical changes to technology and constraints on how to achieve growth in a world in which markets discipline governments against statist development strategies that require unsustainable debt levels.

But capital account liberalization is also a political process driven by domestic political factors such as party ideology, fragmented legislatures, and neoliberal cabinet ministers as well as international political factors such as IMF conditionality (Karcher and Steinberg 2013). Pandya (2010) finds politics can also explain FDI liberalization; democratization is associated with decreasing domestic ownership requirements, presumably because the median voter (labor) benefits from FDI inflows. While easing FDI equity restrictions reflects in measures of capital account openness, FDI policy is more complex than *de jure* restrictions on entry of foreign investors. Investment policies can also include tools meant to incentivize foreign investment, sometimes indiscriminately and other times at the industry level. Thus, policies toward FDI reflect the confluence of two choices – whether to allow and, if so, whether to encourage investment. Additionally, FDI policy must consider these two questions at the aggregate, sector, and industry level. In doing so, investment policy creates distributional

conflict within society. Policies toward FDI, therefore, reflect the outcomes of a political contest between those who benefit from and those who are disadvantaged by the inflow of foreign capital. Pinto (2013) finds evidence that partisanship matters for FDI composition. Left parties are associated with labor-intensive FDI; the implication is that left governments pursue policies designed to attract investments that will create many jobs.

This project extents such analysis of the societal-based explanations for investment policy from a democratic context to autocracy.[1] Indeed, for reasons explained below, autocratic openness to FDI is profoundly puzzling. Yet, autocracies vary substantially in their openness to foreign investment. Furthermore, some of the most important contemporary destinations for FDI are non-democracies such as Vietnam, China, and Malaysia. The central question of this research project is under what conditions will non-democracies allow and promote foreign investment. The implication is that by altering political and economic power within society, FDI has the potential to profoundly change political institutions within society and the extent to which governments incorporate elite and mass interests.

2 A Domestic Political Theory of Investment Policy Formation in Non-Democracies

In this section, I first draw upon trade theory and the literature on FDI spillovers to establish assumptions about relevant actors' preferences over investment policy. I then explicate a theory for preference aggregation through autocratic institutions.

[1] It is important to note that there have been some studies of investment policies under authoritarian regimes, but extant work emphasizes state capacity and policy diffusion rather than preference aggregation. See Johnson (2013).

Preferences over FDI

Inward FDI has distributive consequences because it changes the relative demand for different factors of production. Thus, the domestic politics of FDI is theoretically similar to the domestic politics of trade. While the trade literature problematizes domestic support for trade openness, contemporary scholarship on FDI tends to assume governments of all kinds attempt to maximize investment flows. FDI is robustly associated with economic growth and is also the most stable type of capital flow (Kobrin 2005). Yet, because foreign investment creates domestic winners and losers, government policies toward FDI should reflect the preferences of politically powerful and well organized interest groups. Indeed, openness to FDI varies considerably both temporally and cross-sectionally.

The trade literature offers two models of domestic preference formation: the Stopler-Samuelson model of preference cleavage along factor lines and the Ricardo-Viner model that emphasizes a sectoral orientation of preferences over trade openness. Theoretical treatment of preferences over FDI easily map onto these two theories. Openness to FDI increases the supply of capital domestically and increases demand for domestically-supplied labor (Moran 1978, 1999; Kobrin 1987; Pinto and Pinto 2008). Thus, assuming perfect factor mobility across sectors, FDI increases returns to labor while decreasing returns to capital. If factors display limited sectoral mobility, FDI inflows will increase returns to industries that have complementaries with FDI and decrease returns to industries that compete with FDI (Pinto 2013).

Identifying the domestic winners and losers from inward FDI requires determining the degree to which factors are mobile across sectors as well as which domestic industries are complementary to FDI and which compete with FDI. Within the context of developing economies, there is generally a consensus that factor mobility, especially labor mobility, is an appropriate assumption because production regimes tend to be less capital intensive and

employ low-skilled labor intensively (Pinto 2013). While domestic capital may be less mobile, complementaries between MNEs and domestic firms are typically difficult to find due to a lack of domestic economy absorptive capacity (Moran 2005). It may be most appropriate, therefore, to model domestic preference over FDI in developing economies along factor lines. However, governments can use investment policy to attempt to cultivate complementaries between MNEs and domestic firms. Such policy instruments are often cast at the industry level which suggests while unrestricted FDI openness is generally harmful to domestic capital returns, some industries are more successful at rent-seeking lobbying than others.

In the remainder of this section, I explicate the theoretical and empirical basis behind the preference assumptions I make for domestic labor and capital as well as for governments. This framework of preference formation privileges individuals as producers - the way in which individuals participate in production regimes explains their preferences over FDI policy. It is worth noting, however, that FDI inflows also have important implications for consumers. Even in developing economies, over 60% local MNE affiliate sales are to the domestic economy.[2] This figure remains relatively constant over the past 20 years.

While trade almost always benefits consumers by increasing competition and transferring producer surplus to consumers, FDI does not have such immediately apparent benefits to consumers. MNEs tend to invest in industries characterized by monopolistic or oligopolistic structures (Marshall and Stone 2012). Therefore, MNE entry through FDI often leads to concentration, increased prices, and monopolistic rents, and this may make FDI unpopular among consumers (Li and Resnick 2003; Lin and Saggi 2005). Yet, standard collective action theory suggests diffuse costs make consumer group political action less likely. While consumers may experience small increases in costs of goods produced by MNEs, it is unlikely that they will be able to mount sustained and effective lobbying efforts against FDI given incentives to free-ride. Because the costs and benefits of FDI to consumers is complex

[2]BEA data, my own calculation

and because consumers typically have difficulty maintaining politically powerful lobbying groups, I believe it is appropriate to focus on individuals' roles in production regimes when constructing assumptions about preferences over FDI.

Domestic Labor Preferences Over FDI

Most theoretical and empirical studies of FDI concur that domestic labor tends to benefit from inward FDI. There is robust evidence that MNEs consistently pay wage premiums to their workers (Feenstra and Hanson 1997; Moran 2002; Figini and Görg 2006). Furthermore, there is some evidence that FDI creates positive wage spillovers, suggesting that FDI raises the demand for labor sufficiently to affect wage rates in all firms. Opinion data corroborate theoretical expectations that labor tends to view FDI favorably, and that more highly educated workers are more enthusiastic about such investment (Pandya 2010). For these reasons, I assume that labor always prefers openness to FDI.

Domestic Capital Preferences Over FDI

One of the justifications for incentivizing FDI is that MNEs create positive externalities that spur growth and benefit local firms (Thomas 2007). Yet, empirical evidence suggests the spillover effects of FDI are limited and quite conditional on characteristics of particular investment dyads. A state's ability to benefit from spillovers generally depends on its absorptive capacity, which in turn is a function of its level of economic development, human resource capabilities, and the level of competition in its domestic market (Blomstrom and Kokko 2003; Kokko and Blomstrom 1995). Because developing countries are typically characterized by low levels of all three requirements, FDI generates less spillovers in such countries (Lipsey and Sjöholm 2005; Lin and Saggi 2005) However, limited spillover effects are not the same as no spillover effects. Conceptually, FDI may induce two types of posi-

tive externalities to domestic firms. Horizontal spillovers occur at the intra-industry level. Vertical spillover occur at the inter-industry.

There is little evidence that FDI consistently fosters positive horizontal spillovers. Theoretically, the presence of FDI in a given industry may generate sufficient competition to spur domestic firms to pursue strategies aimed at increasing productivity. Additionally, the presence of FDI may generate knowledge spillovers as domestic firms hire away talent from MNEs operating in the same industry. Workers trained in MNEs can transmit new knowledge to domestic employers about operational efficiency, management strategy, and technical expertise (Görg and Strobl 2005; Blalock and Gertler 2005; Moran 2002). However, there is little evidence that FDI consistently provides positive horizontal spillovers. Indeed, a meta-analysis of 52 empirical studies found FDI brings no positive horizontal spillovers on average (Irsova and Havranek 2013). To the extent that FDI does create intra-firm positive externalities, these effects are relatively small and most likely when FDI comes from countries that have only a small technological advantage over host economies and when MNEs form joint ventures with local partners (Blalock and Gertler 2009; Sawada 2010).

There is greater evidence that FDI generates positive vertical spillovers, but such effects are conditioned on several economic attributes and host country investment policies. To the extent that MNEs exist within value chains, they can generate positive externalities for host economies when they support local suppliers of intermediate goods and when they supply higher quality and less expensive component parts for upstream domestic firms. A MNE may generate large volumes of sales for a downstream supplier, and these sales orders may be more robust to domestic business cycles and financial crises than orders from domestic firms (Blalock and Gertler 2005). Higher sales volumes may make investment in technology with increasing returns economically feasible (Moran 2001). Moreover, MNEs may provide technology transfer to local suppliers in order to prevent supply bottlenecks and to lower production costs (Blalock and Gertler 2005). A meta-analysis of over 100 empirical

studies on vertical spillovers finds robust evidence of positive effects of FDI on backward linkages, meaning for local MNE suppliers, but no effect for forward linkages, meaning for local MNE customers (Havranek and Irsova 2011). However, these effects are conditional on both economic attributes of home and host countries as well as investment policies of host governments. Linkage effects are greater for FDI from distant countries with only modest technological advantages over host economies and when hosts are relatively open to trade and have underdeveloped financial sectors. The manufacturing sector generates more positive spillovers than the service sector. Linkages are more likely when MNEs form joint ventures with local firms; this finding suggests government investment policy strongly influences backward linkage generation since MNEs often only enter such arrangements when governments require it through equity restrictions or incentivize it through tax policy (Pinto 2013).

The empirical record therefore indicates that domestic firms in developing economies are least poised to reap gains from linkages with MNEs; domestic capital will prefer to restrict inward FDI. While domestic capital will display a general preference to limit foreign investment, firms can organize around sectoral and industrial categories to lobby for specific restrictions and requirements on foreign firms. Because government policy can foster linkage through mandating and incentivizing joint ventures, domestic procurement, and technology transfer, and because such policies are often crafted at the industrial level, lobbying may organize around industries and sectors. In sum, domestic capital hold homogeneous interests to restrict FDI, but firms will often organize at the industry level to influence investment policy.

Host Government Preferences Over FDI

Host governments aggregate domestic interest group preferences over FDI, but they do so while also holding autonomous preferences over FDI inflows. Host governments place political survival as their primary goal, but they also want to maximize revenue, which in turn can help them maintain power. For this reason, governments would like to attract as much FDI as they can without jeopardizing political survival.

Aggregating Preferences Over FDI

Extant literature on authoritarian elections and economic performance suggest political institutions that facilitate constraint of the executive and the growth of domestic constituencies should increase domestic investment but not foreign investment since foreign firms are not members of a domestic political elite class (Wright 2008; Gehlbach and Keefer 2011, 2012). However, because FDI has distributive consequence among domestic groups, autocratic political institutions should systematically affect policies toward foreign investment. Institutions that empower domestic capitalists should lead to policies designed to protect domestic firms against foreign investors while institutions that empower labor groups should lead to policies designed to create jobs through increased foreign investment.

As describe above, FDI broadly favors labor and broadly reduces returns to domestic capital. Therefore, FDI openness in autocratic regimes is rather puzzling. A liberal FDI environment benefits groups that are typically considered outside ruling elites' winning coalitions and disadvantages those who are. According to most prominent theories of non-democratic rule, autocratic politics is limited to rent-seeking among elites. Selectorate theory argues rulers will find it more efficient to provide members of their winning collation with private goods than to invest in broad based pubic goods since the winning coalition and the electorate are relatively small in autocratic regimes (Bueno de Mesquito, Smith,

Siverson and Morrow 2003). Yet, the variance in economic growth rates and measure of economic inequality in autocracies suggests there may be situations under which autocratic rulers will choose to pursue strategies that benefit groups outside a small, elite winning coalition. Acemoglu and Robinson (2006) contend autocrats face an important trade-off between enriching elites versus providing economic and political benefits to the masses. They explain patterns of distribution of economic resources and political power as a function of the competing threats of coup attempts from fellow elites and revolutionary attempts from below. This conceptualization of the constraints autocratic rulers face allows space for how popular support and resistance can influence decision-making even in polities that place great restrictions on political participation. Thus, the strength of the autocratic coalitions, conceptualized as the ability of the ruler to resist challenges from other elites as well as from the masses, might better explain patterns of distribution than can the size of the electorate and winning coalition.

The growing literature on competitive authoritarianism places elections at the center of distributive politics in autocratic regimes.[3] From this literature, multiple theories of elections emerge (Gandhi and Przeworski 2006; Jensen, Malesky and Weymouth 2011). These theories may not be mutually exclusive - elections might have several purposes and effects.[4] Broadly, theories of elections under autocracy vary in their emphasis of either how such institutional structures influence inter-elite bargaining or the extent to which elections foster delegate

[3] An important and direct challenge to this analytical framework focuses on categorizing autocracies into a few categories of institutional complexes that incentivize different patterns of economic distribution (Geddes 1999; Brownlee 2007). This literature, with roots in studies of autocratic durability, emphasize elections as having heterogenous functions and effects.Brownlee (2007, 2008) argues elections by themselves have little explanatory effect on regime stability because both the purpose and timing of elections are endogenous to much stronger causal forces operating within regimes. However, even within this tradition, the role of elections in conjunction with strong parties is clearly central (Wright 2008; Geddes 1999; Waldner 1999; Gandhi 2008; Gallagher and Hanson 2009).

[4] Much of the literature on elections under authoritarianism starts from the premise that elections provide some sort of function for autocratic leaders. This is because autocrats presumably have more control over whether elections are held, the rules that govern political contests, and the results. Thus, much of this literature takes a functionalist view of elections and does not explain in depth the unintended consequences of introducing elections within an authoritarian context. See **CITE source on unintended consequences**

responsiveness to the interests of non-elites. Elections might function mostly at the inter-elite level by signaling strength to potential opposition (Geddes N.d.; Simpser 2005; Magaloni 2006; Malesky 2008), by distributing private goods among ruling elite (Lust-Okar 2006; Blaydes 2008), by allowing rulers to credibly commit to rank-and-file elite that they will be promoted with regularity (Magaloni 2008), or by co-opting the opposition (Lust-Okar 2006; Beaulieu 2006; Gandhi 2008).

Elections might also function to increase government responsiveness to mass interests. Since autocracies are typically low information environments, elections can serve to identify bases of support and opposition within society and use such information to reward supporters and punish popular opposition (Ames 1970; Magaloni 2006; Brownlee 2007). Pepinsky (2008) finds evidence of political business cycles in Malaysia. Elections may also provide information to party leadership about the loyalty and competence of lower-level elites, which encourages elites to develop local (and therefore non-elite) bases of support (Birney 2007; Blaydes 2008). Accordingly, elections might tie delegates to local constituents who are generally less well off than the wealthy supporters of the autocrat's inner policy circle. Malesky and Schuler (2010) find decentralized candidate nomination processes in Vietnam lead to more redistributive economic policies. Finally, elections might have little effect on domestic interest aggregation and be merely a show for an international audience (Schedler 2006).

In other words, electoral competition in an authoritarian context has countervailing effects. One the one hand, elections may make political elites more responsive to growing local constituencies comprised mostly of labor. On the other hand, elections confer important power on strong parties, which oftentimes derive their power from centralized elites rather than decentralized masses.

Ruling parties and competition among multiple parties within a legislature facilitate cooperation and compromise among political elites. Jensen, Malesky, and Weymouth (forth-

coming) find party competition in authoritarian regimes leads to strengthened commercial legal environments precisely because parties in autocratic contexts facilitate elite cooperation rather than give voice to mass groups. Gehlbach and Keefer (2011, 2012) argue that highly institutionalized parties allow party elites to constrain the autocrat by making threats of collective action against him credible. When parties are institutionalized, elites develop their own constituents and are able to use party institutions to discipline the autocrat if he pursues policies that are detrimental to their bases of support.[5] In these contexts, elections function to transfer political power from executives to other societal elites. Under such conditions, elections will confer upon the domestic capitalist class more policy-making influence. Accordingly, when elections are dominated by strong ruling parties and competition among elite-oriented parties, investment policy will protect domestic capital against foreign investors.

However, autocrats do not only contend with potential political challenges from societal elites. Autocratic governments must also control mass discontent to maintain power. Of course, autocrats do retain the ability to repress mass protests through media control as well as violence, but doing so is costly and even non-democratic leaders often prefer to maintain societal complacency through political concessions than through repressive force. While elections under authoritarianism often function as mechanisms through which societal elites can collectively restrain executives and, in doing so, strongly influence the policy-making process, elections also create possibilities for the articulation and incorporation of mass preferences

[5] Party-institutionalization is closely related to single-party regimes. The main difference is that party institutionalization is a continuous rather than dichotomous concept. Such an approach allows for greater variation of relevant party structures than a focus on single-party regime can accommodate. Gehlbach and Keefer measure institutionalization as the age of the ruling party minus the number of years the current executive has been in power (2011). This approach addresses important differences between single-party regimes. For example, Syria and China are both single-party regimes under the Geddes-Frantz-Wright classification. While Syria has had two heads of state - a father and son - since 1971, China has had five over the same time period. To the extent that more regular succession of party leadership represents the development of stronger institutionalization may be better poised to measure the precise ways in which autocratic institutions may structure rulers' preferences over patterns of distribution.

into autocratic governance. In particular, when labor displays organizational capacity, autocratic leaders must take their preferences more seriously. This is more likely to be the case when urbanization rates are high because labor is more geographically concentrated. In the specific case of investment policy, urbanization also creates a wage-earning class dependent upon non-agricultural or extractive economic activity while simultaneously making the benefits of foreign investment more visible and salient.

In sum, elections under authoritarianism have implications for how preference aggregate in society because electoral institutions subject leaders and delegates to garner the support of some larger constituent group. But, the presence of elections alone does not predict government policies with distributive implications because elections benefit societal forces that are politically strong, and the strength of such groups varies across countries. While elections with highly institutionalized parties confer power among political elites who use legislative and party institutions to overcome inter-elite collective action problems, elections are more likely to create responsiveness to mass interests when labor is concentrated in urban settings where political and industrial organization is more tenable. This theory of the conditional effect of elections on investment policy generates the following two hypotheses:

Hypothesis 1: Under elections, highly institutionalized parties will be associated with investment policies designed to protect domestic capitalists' interested.

Hypothesis 2: Under elections, the capacity for labor to organize politically will be associated with investment policies designed to attract foreign investment.

3 Empirical Analysis

Case selection

I constructed my universe of cases to include all countries that had substantial impediments to democratic rule in the year 2000, the year in which my data begin. I consulted two widely used measures of regime type - Freedom House and the Wright, Frantz, and Geddes dataset which classifies autocratic regime subtype. For Freedom House, I included all countries rated not free or partially free in 2000. For the Wright, Frantz, and Geddes dataset, I included all countries that were considered non-democracies in 2000. If the two datasets disagreed, I included the country anyway. For instance, Freedom House classifies Macedonia as a non-democracy in 2000 while GWF does not. I do not include countries with a population less than 1 million in 2000. Research on FDI tends to exclude these countries because investment in very small countries is highly distorted, often driven by banking flows, and follows different logic than decisions to invest in larger countries. This left me with 82 countries.

Measurement

Outcome Variables

My dependent variable, conceptually, is investment policy. I draw on UNCTAD's database of investment policy changes, which codes every policy change related to investment policy in a given country in terms of whether the change is positive or negative for FDI. The dataset has temporal coverage from 1992-2011. Due to a change in coding rules, UNCTAD only provided me with data from 2000 onward. This analysis, therefore, is constrained to 2000-2011. The next iteration of the analysis will include data from 1992-1999. From this data, I create a number of variables. I separate policies over entry from policies over promotion.

Conceptually, reducing domestic ownership requirements is quite a different policy from tax incentives targeted to foreign investment. The first policy merely allows foreign investment through liberalizing the capital account. The second policy actively encourages such investment activity. Second, I distinguish between policies that are favorable to FDI and policies that are antagonistic toward foreign investors. Third, I differentiate between policies that apply generally and policies that are targeted toward specific industries or sectors. Fourth, for promotion policy, I distinguish between policies that apply solely to foreign investment and policies that also apply to domestic firms. I, therefore, have several outcome variables that each measure investment policy from a different angle. The outcome variables that I explore in this analysis include *Favorable Entry Policy* and *Favorable Promotion Policy.* Future iterations of the project will also use *Favorable Sector-level Policy*, *Unfavorable Entry, Promotion, and Sector-level Policy*, and *Favorable and Unfavorable FDI-specific Policy.*

Explanatory variables

I use three main explanatory variables: competitive elections, ruling party institutionalization, and urbanization. Following Gehlbach and Keefer (2012), *Competitive elections* is an indicator variable that takes on the value of "1" if a country holds regular legislative elections and if the last such election was competitive, meaning more than one candidate vied for a single legislative seat.[6] *Ruling Party Institutionalization* also comes from Gehlbach and Keefer (2012), and subtracts the number of years the executive has been in power from the number of year the the ruling party has been in existence. If an executive's rise to power predates ruling party formation, this variable is coded "0." The concept measured here is the extent to which the party is institutionalized beyond the executive's rule. Again, measures of executive tenure and ruling party age come from the Database of Political Institutions. Finally, my theory expects the capacity of labor organize will affect investment policy. I proxy

[6] Electoral competitiveness comes from the Database of Political Institutions (Keefer 2010).

for *Labor Organizational Capacity* through urbanization rates. When labor is concentrated in cities, proximity makes organization more likely. Because I argue the effect of elections on investment policy is conditioned on what groups in society are empowered by electoral institutions, I interact *Competitive elections* on *Ruling Party Institutionalization* as well as on *Labor Organizational Capacity.*

Control variables

I control for economic, human resource, and dependency features that might affect investment policy.[7] First, governments are constrained by their level of development, current levels of investment, and balance of payment positions. Unfortunately, *GDP*, *Domestic Gross Capital Formation*, *FDI*, and *Reserves* are all highly correlated. I choose to include a log transformation of *GDP* in the model. Next, human resource endowments may affect the type of development strategies governments pursue. I control for both *Population*, log transformed, and *Skills*, proxied through primary enrollment figures. States highly endowed in natural resources may face less pressure to diversify economic activity. Therefore, I control for *Resource Rents*, again log transformed. Finally, some developing countries are dependent on concessionary loans from the IMF or foreign aid from developed countries. Since such aid is often conditional on structural adjustment policies generally, and capital account liberalization particularly, I control for *IMF Influence*, proxied through the logged value of IMF loans outstanding, and *Aid Dependence*, measured by official development assistance scaled by gross national income and log transformed.

[7] These data come from the IMF's International Financial Statistics Database.

Estimation

My two main outcome variables are *Favorable Entry Policy* and *Favorable Promotion Policy*. Each of these are coded "1" for any country-year in which a favorable policy change was made and "0" otherwise. Because my outcome variables are on a [0,1] support, I use maximum likelihood estimation with a logit link function.

$$
\begin{aligned}
PolicyChange_{i,t} = \quad & \alpha_{i,t} + Elections_{i,t} + RulingPartyInstitutionalization_{i,t} \\
& + Elections * RulingPartyInstitutionalization_{i,t} + GDP_{i,t} \\
& + Population_{i,t} + PrimarySchoolEnrollment_{i,t} + Urban_{i,t} \\
& + IMFLoansOutstanding_{i,t} + OfficialDevelopmentAssistance_{i,t}
\end{aligned}
$$

To aid in interpretation, especially of my interaction terms, I standardize all variables by centering them around their means and dividing them by their standard deviations. To test robustness of my results, I also estimate constrained models that exclude variables that fail to show statistical significance but also, due to data missingness, drop observations from the estimation. I also run separate analyses of each model with year dummies and country dummies. Generally, I find my results are robust to year dummies but not to country dummies. This is not surprising because my time series is rather short and most of the theoretically important variation in my explanatory variables is cross sectional.

Results

Table 1 provides regression output. Figure 2 provides graphical interpretation of the effects of *Ruling Party Institutionalization* and *Urbanization* on investment policy outcomes with and without elections.

[Insert Table 1 here]

[Insert Figure 2 here]

I interpret these results with caution for two central reasons. First, these models remain crude and my residuals remain rather large. I need to spend more time with model specification, most importantly to deal with selection and spatial effects. I plan to experiment with spatial regression analysis as well as with two level models that may help overcome these modeling challenges and increase model fit. Second, my data are incomplete in two main respects. Right now, my investment policy data only extend back to 2000. My next round of data coding will extend this back to 1992, which will not only increase my N, but also extend my sample back to the beginning of the rapid trend toward FDI liberalization. Additionally, some theoretically important controls are incomplete in my data. Once I have my full sample, I will conduct multiple imputation to reduce the number of case-wise deletions in the dataset.

With these caveats in mind, I discuss the main findings of my statistical analysis. To reiterate the main emphasis of my theory, I argue nominally competitive elections within authoritarian contexts place demands on "representatives" to generate constituents toward whom they become increasingly responsive (though, perhaps not accountable). However, the constituencies autocratic politicians develop depend upon what groups in society have the organizational power to act collectively. In general terms, we can consider when labor is going to have the capacity to pursue collective political action and when domestic capitalists will. I use urbanization for a proxy for the potential political strength of labor and ruling party institutionalization as a proxy for the collective strength of capital. I find preliminary support for my argument that the effect of authoritarian elections on policies with distributive effects is conditional on the strength of these two broad societal groups.

First, let's consider policy changes designed to statutorily open an economy to FDI inflows. We can broadly view such policy changes as positive for labor and damaging for capital. I find legislative elections and ruling party institutionalization are both positively associated with liberalizing entry policies, but that jointly elections and well established parties lead to less liberalization of entry policies. On the other hand, there is no statistically significant association between entry policies and the interaction between legislative elections and urbanization. This suggests that there is a bias toward liberalizing investment laws, but that when domestic capital has the capacity to organize collectively through an institutionalized party and the ability to influence autocratic politicians through elections, domestic capital is able to retain restrictions against inward FDI.

These findings are quite different from how domestic political institutions affect policy changes designed to promote FDI inflows through various incentive programs. We may consider incentive programs as attempts to promote job creation. This is consistent with how governments often discuss and justify incentive programs, even if such program achieve mixed results. Here we find no statistically significant association between such policy changes and the interaction of elections and ruling party institutionalization. What we do see, however, is that elections without high rates of urbanization and high rates of urbanization without elections both decrease the probability of promotion policies. However, within the context of elections, high urbanization rates increase the probability of promotion policies. This suggests that there is a bias against promotion policies, but that when labor has the capacity to organize collectively and the ability to influence autocratic politicians through elections, autocrats are more likely to pursue policies designed to create jobs, even when doing so hurts domestic capitalists.

So, at the aggregate level, we have some evidence that investment policies in autocracies reflect distributive preferences of politically important societal groups. However, there are a couple of concerns with these data. First, is it appropriate to interpret the negative coefficient

on the interaction between ruling party institutionalization and elections as indication that more institutionalized parties are less likely to pursue liberalizing policies or is it more appropriate to interpret this outcome as indication that parties that pursue liberalization do so quickly after they come to power? This question is difficult to answer with my current dataset, but is less of a problem once I extend my dataset back to 1992 because my time series will then begin before most liberalizing policies were enacted. Second, we know from the trade literature that lobbying for protection usually occurs at the industrial level. Do the importance and direction of political variables hold for investment policy changes at the industry level? In short, preliminary analysis of *Favorable Sector Level Policy* indicates that my main findings hold at the industrial level. However, I do not report these results in detail because I think it is most appropriate to estimate those models using a poisson link function, but my sector-level policy variables are currently not on a $[0, \infty]$ support.

4 Conclusion

As with trade, FDI flows have distributive implications and therefore generate domestic political coalitions supporting and opposing both liberalization and promotion policies. Governments do not display homogenous preferences for FDI inflow maximization, and FDI policy varies systematically with domestic political institutions that aggregate societal preferences. This process of aggregation also occurs in autocratic regimes. I find preliminary evidence to support my two main hypotheses that the effect of elections on FDI policies is conditional on the strength of two broad societal groups, capitalists and labor. These findings have important extensions beyond FDI policy to capital account openness more broadly and, indeed, any governmental policies with broad distributional effects.

Of course, there are several caveats as well as planned extensions to this analysis that must temper interpretation of my findings. First, my current model specifications ignore spatial

and selection effects. Future iterations of this project must incorporate such concerns into inferential statistical strategies. Second, my sample is limited and shows changes in policies and is therefore sensitive to policies as they stood in 2000. If a country reformed its FDI policy in 1999 and then did not promulgate any policy changes in the ensuing decade, my current analysis does not incorporate any information about the investment policies in that country. As I update my dataset to include policy changes back to 1992, much of this concern will dissipate as the majority of FDI liberalization in developing countries occurred after 1992. Finally, my data is at a highly aggregated level and does not direct test the mechanisms of aggregation over which I theorize. Of course, this is a feature of all large n statistical analysis. Deeper understanding of the specific causal processes through which societal groups influence investment policy in non-democracies requires closer qualitative analysis and process-tracing of the policy-making process. Further iterations of the larger research project will include analysis of specific cases of large-scale change to an investment policy regime.

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Table 1: Determinants of Investment Policy Changes

	Model 1	Model 2	Model 3	Model 4
	Entry	Entry	Promotion	Promotion
Elections	3.46659	0.01194	-0.26240	1.55743
	(2.52651)	(0.64209)	(0.68792)	(1.06502)
Instit. Party	1.71870*	-0.07259	-0.48840	-0.03311
	(1.03535)	(0.13786)	(0.41128)	(0.15471)
Urban	-0.65749**	0.27550	-0.53420*	-2.24697**
	(0.27076)	(0.89650)	(0.31607)	(1.05920)
Elections X Party	-1.82005*		0.44959	
	(1.03109)		(0.40300)	
Elections X Urban		-0.98238		1.72017*
		(0.87757)		(0.99825)
log(GDP)	1.18309**	1.32976***	1.17394**	1.23976**
	(0.48711)	(0.48240)	(0.56270)	(0.56994)
log(Pop)	-0.53399	-0.50428	-0.30923	-0.34136
	(0.38184)	(0.38265)	(0.44909)	(0.45218)
Primary Enrollment	0.03228	0.04657	-0.04243	-0.01806
	(0.14115)	(0.14137)	0.16898	(0.16995)
Resource Rents	0.08038	-0.02744	-0.21388	-0.17209
	(0.17356)	(0.17016)	(0.21285)	(0.21108)
IMF Loans	-0.18841	-0.15935	-0.28194	-0.23175
	(0.18165)	(0.17698)	(0.19731)	(0.19891)
ODA/GNI	-0.18037	-0.25415	-0.15041	-0.13952
	(0.17080)	(0.16736)	(0.19897)	(0.19911)
Constant	-4.95456	-1.53506**	-1.82907***	-3.66011***
	(2.28)	(0.63929)	(0.66494)	(1.09194)
AIC	469.94	476.55	377.21	375.29

MLE, logit link function with standard errors in parentheses. * p<0.1, ** p<0.05, *** p<0.0; two-tailed tests. N=974, n=82; analysis covers 2000-2011 subject to data availability.

Figure 1: Variation in FDI Flows By Regime Type

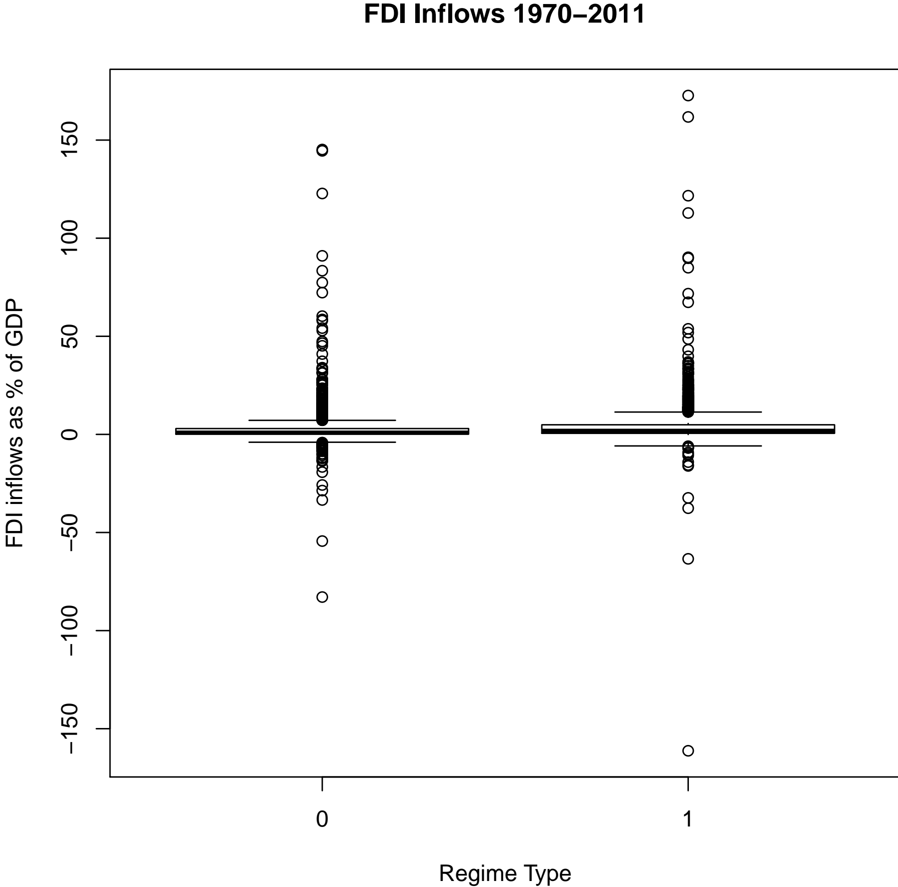

Figure 2: Societal Group Strength, Elections, and Investment Policy Changes