Distributional Consequences and Executive Regime Types: The Politics of Foreign Direct Investment Incentives

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Abstract

This dissertation examines variation in the provision of foreign direct investment (FDI) incentives. If FDI is crucial for economic growth, why do some countries offer high levels of incentives to attract FDI, while other countries do not? This study identifies the political dimensions behind FDI incentives provision in democratic countries.

I argue that provision of FDI incentives depends on the distributional consequences of FDI and a country's executive regime type. FDI inflows compete up wages and drive down rents, which implies that labor prefers high levels of FDI and FDI incentives, while native capital opposes FDI and FDI incentives. These preferences towards FDI incentives are moderated, however, by a country's executive regime type. In parliamentary democracies, legislative cohesion engenders large, stable political coalitions. This leads to policies that are beneficial to a broad majority of a country's population, namely labor. As a result, parliamentary democracies provide higher levels of FDI incentives. By contrast, presidential democracies feature strong separation of powers, which means policy coalitions will be temporary and

unstable. Coalition instability means that the beneficiaries of FDI incentives must work to convince institutional actors to support FDI incentives. This drives down the level of incentives because some institutional actors prefer lower levels of incentives compared to others and the beneficiaries will accept any incentives level approved. As a result, presidential democracies provide lower levels of FDI incentives.

After deriving testable hypotheses using the tools of game theory, I examine the politics of FDI incentives provision using an original cross-national dataset of FDI incentives generated with machine learning techniques. I empirically analyze this dataset with pooled and fixed effects maximum likelihood estimation models. I then explore the politics of FDI incentives provision in two complementary case studies from Poland, a parliamentary democracy, and Romania, a presidential democracy. A final empirical chapter uses unique survey data from Poland to study individual-level attitudes towards FDI incentives. The cross-national statistical analysis reveals that higher levels of legislative cohesion are associated with greater provision of FDI incentives. The case study research shows that parliamentary democracies are associated with higher levels of FDI incentives and presidential democracies are associated with lower levels of FDI incentives. Finally, the survey data analysis shows that labor prefers FDI incentives to a greater extent than native capital.

Contents

Abstract **i**

Contents **iii**

List of Figures **ix**

List of Tables **xi**

Acknowledgements **xiii**

1 Introduction **1**

1.1 Overview 1

1.2 Foreign direct investment 4

1.3 FDI incentives in political science 8

1.4 Question of dissertation 10

1.5 Puzzle of dissertation 13

1.6 The argument 14

1.7 Plan of dissertation 16

2 Theory and literature review **18**

2.1 Introduction 18

2.2 Overview of the literature 19

2.2.1 The politics of foreign direct investment 19

2.2.2 The politics of FDI incentives 24

2.2.3 Problems with the literature 29

2.3 Theory 31

2.3.1 Demand for FDI incentives 31

2.3.2 Supply of FDI incentives 35

2.3.3 Equilibrium FDI incentives 39

2.4 Conclusion 40

3 A political economy model of FDI incentives **42**

3.1 Introduction 42

3.2 Legislative bargaining over FDI incentives 45

3.3 Baseline models: parliamentary and presidential regimes 48

3.3.1 Parliamentary regime 48

3.3.2 Presidential regime 53

3.3.3 Discussion 57

3.4 FDI inflows and executive regimes 58

3.4.1 Parliamentary regime 58

3.4.2 Presidential regime 61

3.5 Conclusion 63

4 Legislative cohesion and FDI incentives: results from cross-national empirical analysis 65

4.1 Introduction 65

4.2 Data 67

4.2.1 Dependent variable 67

4.2.2 Independent variables 72

4.2.3 Controls 74

4.3 Post-socialist cases 77

4.4 Pooled ordinal analysis 81

4.4.1 Empirical strategy 81

4.4.2 Results 82

4.4.3 Model robustness 88

4.5 Panel data analysis 89

4.5.1 Potential issues 89

4.5.2 Model fit comparison 90

4.5.3 Empirical strategy 92

4.5.4 Results 93

4.5.5 Model robustness 99

4.6 Conclusion 99

4.7 Appendix 101

5 Parliamentarism and FDI incentives in Poland 102

5.1 Introduction 102
5.2 Transition 104
5.3 FDI, cohesion, and legislative/executive deliberations 108
5.4 Labor and politics 109
5.5 Polish labor 112
5.6 Domestic business 115
5.7 Poland's executive regime type 117
5.8 Special economic zones in Poland 119
5.9 Cohesion or consensus? 123
5.10 Agriculture 125
5.11 Conclusion 128

6 Semi-presidentialism and FDI incentives in Romania 130

6.1 Introduction 130
6.2 Transition 132
6.3 FDI, cohesion, and legislative/executive deliberations 138
6.4 Romanian Labor 140
6.5 Domestic business 142
6.6 Romania's executive regime type 145
6.7 Industrial parks in Romania 148
6.8 Legislative cohesion 150
6.9 Conclusion 152

7 Preferences towards FDI incentives: survey evidence 153

7.1 Introduction 153

7.2 Literature review 155

7.3 Data 156

7.4 Confirmatory factor analysis 162

7.5 Ordinal analysis 167

7.5.1 Empirical strategy 167

7.5.2 Results 167

7.5.3 Model robustness 169

7.6 Conclusion 172

7.7 Appendix 174

8 Conclusions 175

8.1 Introduction 175

8.2 The politics of foreign direct investment incentives 176

8.3 Gaps in the literature and theoretical approach 179

8.4 Evidence: cross-national analysis 182

8.5 Evidence: case studies 184

8.5.1 Poland 185

8.5.2 Romania 189

8.6 Evidence: survey analysis 192

8.7 Caveats, extensions, and final thoughts 193

8.7.1 Caveats 193

8.7.2 Extensions 196
8.7.3 Final thoughts 200

References **202**

List of Figures

1.1 Global FDI Inflows, 1970-2012 6
1.2 FDI as a Percentage of World Gross Fixed Capital Formation 6
1.3 FDI Inflows as a Percentage of World GDP 7
1.4 FDI Incentives in Post-Socialist Democracies 11
1.5 Property Rights in Post-Socialist Democracies 12
1.6 FDI Incentives, Property Rights, and Executive Regimes in Post-Socialist Democracies 13

4.1 Univariate Distribution of *FDI Incentives* 71
4.2 Univariate Distribution of *Legislative Cohesion* 73
4.3 Univariate Distribution of *Legislative Cohesion*Inflows* 74
4.4 Univariate Distribution of *FDI Incentives*, Post-Socialist Countries 79
4.5 Univariate Distribution of *FDI Incentives*, World 79
4.6 Univariate FDI Incentives and Legislative Cohesion, Post-Socialist Countries 80

4.7 FDI Incentives and Legislative Cohesion, World 80
4.8 Change in Predicted Probabilities, FDI Incentives=0 87
4.9 Change in Predicted Probabilities, FDI Incentives=4 88
4.10 Panel Data, Changes in Predicted Prob., FDI Incentives=0 . . 97
4.11 Panel Data, Changes in Predicted Prob., FDI Incentives=4 . . 98

5.1 Special Economic Zones in Poland 122

6.1 Industrial Parks in Romania 149

7.1 Univariate Distribution of *providefdiinc* 158
7.2 Univariate Distribution of *fdisupport* 158
7.3 Univariate Distribution of *fdiincgood* 159
7.4 Univariate Distribution of *Income* 160
7.5 Path Diagram 163
7.6 Univariate Distribution of Composite Dependent Variable . . . 166

List of Tables

4.1 Machine Learning Algorithm Diagnostics 70

4.2 Reliability Checks 71

4.3 Descriptive Statistics for FDI Incentives, Post-Socialist Countries vs. World 81

4.4 The Effect of Executive Regime Type on FDI Incentives . . . 83

4.5 The Effect of Executive Regime Type on FDI Incentives with Interaction Term 84

4.6 Likelihood Ratio Test Results 91

4.7 The Effect of Executive Regime Type on FDI Incentives, Panel Models 94

4.8 The Effect of Executive Regime Type on FDI Incentives, Panel Models with Interaction Term 95

4.9 Descriptive Statistics 101

7.1 Confirmatory Factor Analysis: FDI Incentives Attitudes . . . 164

7.2 Composite DV and Income 166

7.3 Attitudes towards FDI Incentives, Composite Dependent Variable 168

7.4 Attitudes towards FDI Incentives, fdiincgood variable 170

7.5 Attitudes towards FDI Incentives, Composite Variable Alternative Approach 171

7.6 Descriptive Statistics 174

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Chapter 1

Introduction

1.1 Overview

Our globalized world is and will be characterized by the rapid flow of people, money, capital, and goods across national borders. Led by multinational corporations (MNCs), one of the main features of globalization today is significant change in the nature of global production (Bordo et al. 1999). While there has been an immense outpouring of scholarly literature on the political economy of trade, scholars have only recently begun to seriously examine the politics of foreign direct investment (FDI). For some analysts, the increasingly interconnected nature of the world means that states have no choice but to accept reality and submit to the dictates of global forces. Others suggest that states have even more important roles to play in exerting influence over domestic populations, resources, economies, and cultures.

Attracting FDI has become an extremely important goal for many

states. One prevalent method employed by states to attract FDI inflows has been the provision of FDI incentives, which can be broadly divided into three categories (Cass 2007). First, states provide fiscal incentives. These include tax holidays, tax reductions, investment allowances, tax credits, accelerated asset depreciation, preferential export profits treatment, tax deductions, and exemptions from import duties. Second, states provide financial incentives such as cash grants, subsidized facilities, and infrastructure, such as roads or utility links. Third, states offer investment promotion agencies that provide marketing services and assist companies in navigating bureaucratic obstacles that are often part of the investment process.

In this dissertation, I present a new approach to the politics of foreign direct investment incentives. I limit my focus to a subset of countries, democracies, in order to control for important differences between democracies and autocracies. The theory I propose takes a cue from the intuition that FDI inflows create domestic winners and losers. I argue that FDI incentives policy reflects the preferences of winners and losers from FDI inflows. The theoretical and empirical literature on FDI suggests that workers tend to benefit from FDI inflows (Lipsey and Sjoholm 2004, 2005), while returns to domestic capital in the FDI host country decline (Haddad and Harrison 1993; Feenstra and Hanson 1997; Aitken and Harrison 1999). The translation of FDI incentives preferences into policy, however, is moderated by political institutions. As such, I focus on executive regime type, defined as whether or not a country has a parliamentary or presidential system. Parliamentary systems feature

high levels of legislative cohesion, which imply stable political coalitions that are broadly representative. Large, stable coalitions suggest that the interests of labor are taken into account to a greater extent, which in turn implies that parliamentary systems provide higher levels of FDI incentives.

By contrast, presidential systems have separation of powers, which means that more institutional actors must be satisfied in order for policy changes to be enacted. One consequence of presidential systems is the prevalence of unstable political coalitions. This means that the beneficiaries of FDI incentives have to "sell" the FDI incentives policy to the institutional actors. This drives down the level of FDI incentives because some institutional actors prefer lower levels of incentives as compared to others. The beneficiaries of FDI incentives, however, will accept whatever level of incentives is offered. On whole, this, implies that presidential systems offer lower levels of FDI incentives.

In the remainder of this chapter, I present an overview of FDI and provide reasons for why it should be studied. Next, I preview the relevant political science literature in which I situate my approach to the politics of FDI incentives. I then provide the motivating question and puzzle for my dissertation. The chapter concludes with a brief overview of my argument and a roadmap to the dissertation.

1.2 Foreign direct investment

According to the International Monetary Fund (IMF), an investment is considered FDI if at least a 10% stake in the company in question is under the control of a foreign firm (Lipsey 2001). Hymer's (1976) work was crucial for showing that FDI and portfolio investment are distinct analytical categories of global capital flows. Among others, Kindleberger (1969) and Dunning (1988) built upon Hymer's insight that FDI responds to imperfect markets in order to advance knowledge about MNCs. According to these scholars, by organizing cross-border production hierarchically and internalizing transactions, MNCs engaging in FDI may provide solutions to imperfect allocations of property rights. Caves (1996) notes that FDI usually adopts the form of mobile international capital, but is specific to a host country industry. MNCs, as the originators of FDI, are forces behind the movement of FDI across national borders.

A particular case of FDI may be considered either horizontal or vertical. Horizontal FDI is motivated primarily by the desire to produce goods and services for consumers in the host country. An example would be how Toyota has built car manufacturing facilities in the U.S., which produce vehicles for the U.S. market. Toyota also has factories in the United Kingdom, France, and Portugal, which produce for the European market. By replicating manufacturing sites, Toyota's strategy is aimed at market access and thus is representative of a horizontal FDI approach.

On the other hand, vertical FDI seeks to take advantage of international factor price-differences to produce goods for export. For example, consider the following hypothetical case. Prior to 1991, the Soviet government expended considerable resources to develop an important node for the Soviet military industrial complex in Kharkiv, Ukraine. As such, the Soviet government built significant science and technology education infrastructure as well as a number of interrelated state enterprises in Kharkiv. Since the fall of the Soviet Union, however, Kharkiv's military technology industry has been greatly underutilized. Workers, while highly skilled and trained, are paid low wages. In order to take advantage of low wages for this highly skilled workforce, a foreign company could invest in Kharkiv and export technology products more cheaply than possible in other contexts. By exploiting a favorable factor price and focusing on exports, the foreign company would be exemplifying a vertical FDI strategy.

Research on FDI is important for at least two major reasons. First, as an important dimension of cross-border capital flows, FDI has grown immensely since 1990 (see Figure 1.1). Compared to almost negligible levels in the 1970s, the United Nations Conference on Trade and Development (UNCTAD) estimates FDI flows at $US 1.46 trillion in 2013. As a percentage of gross fixed capital formation, FDI has greatly increased since 1990, albeit with a serious dip following the 2006 global recession (Figure 1.2). FDI has also grown significantly as a percentage of world GDP (Figure 1.3).

Figure 1.1: Global FDI Inflows, 1970-2012

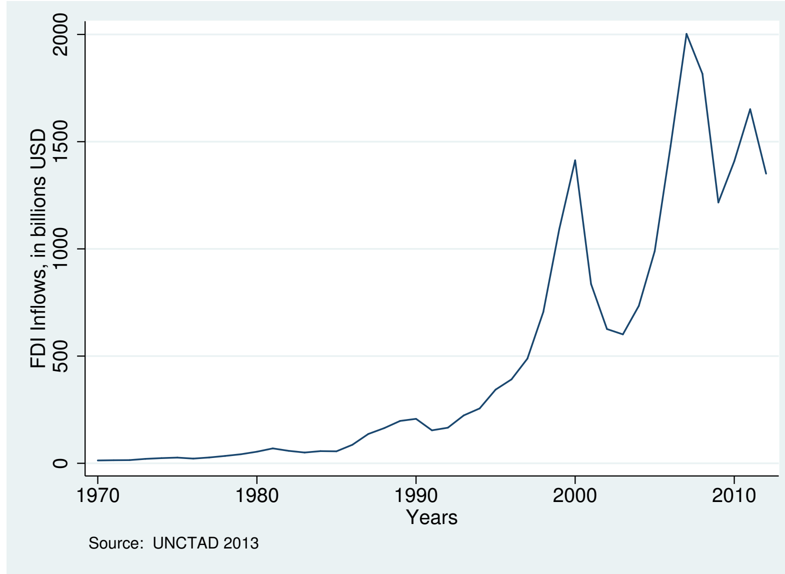


Figure 1.2: FDI as a Percentage of World Gross Fixed Capital Formation

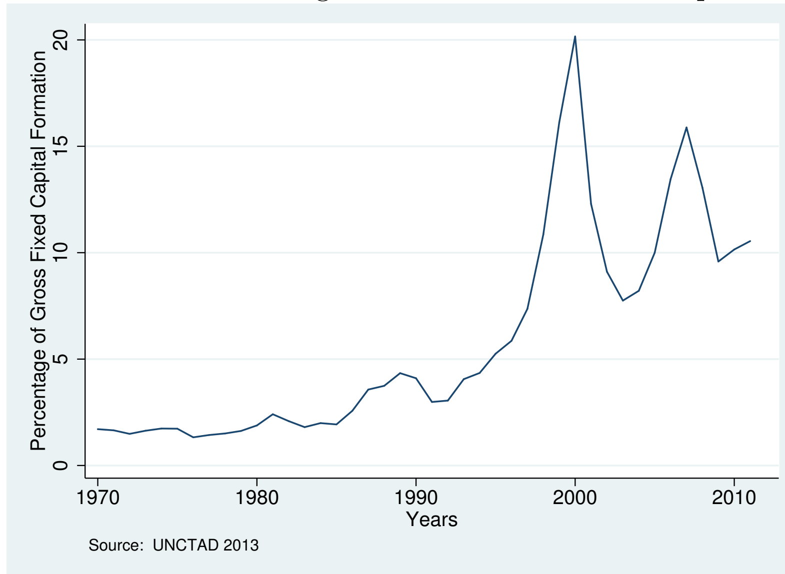
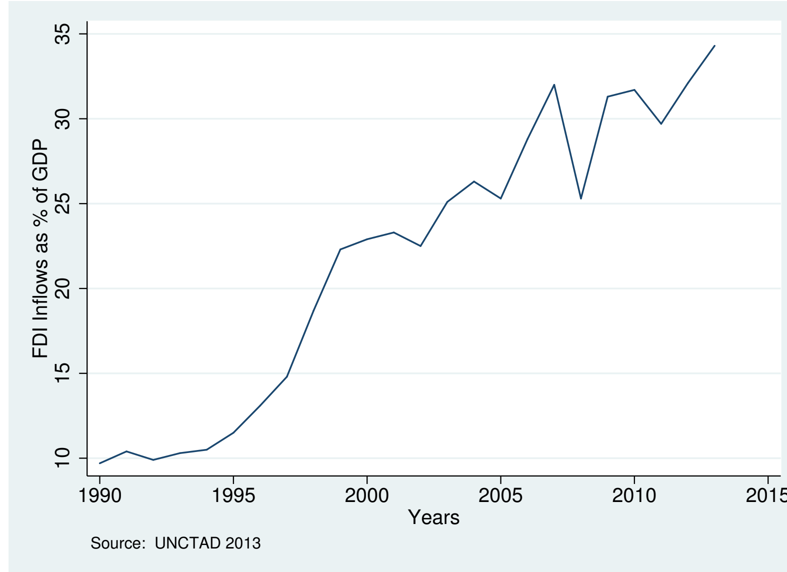


Figure 1.3: FDI Inflows as a Percentage of World GDP



FDI is also considered to be an important topic of study because it is seen as crucial for economic growth and development (UNCTAD 1992, 1999). Scholars propose at least five ways that FDI promotes economic growth and development. First, and perhaps most importantly, FDI contributes to economic growth through transfers of technology. According to Borensztein et al. (1998), technological progress takes place through a process of 'capital deepening' in the form of the introduction of new varieties of capital goods. MNCs possess more advanced 'knowledge,' which allows them to introduce new capital goods at lower cost. Second, FDI fosters 'spillovers' or positive externalities for local economies. (Caves 1974; Blomstrom 1986; Blomstrom and Kokko 2003; Spencer 2008). The increase in competition that occurs as a result of foreign entry may be considered a benefit, in particular if it forces

local firms to introduce new technology and work harder. Third, it has been suggested that FDI inflows increase wages and employment in host countries (Feenstra and Hanson 1997). Fourth, FDI inflows benefit economies that promote exports (Bhagwati 1978) and raise tax revenues (Feldstein 2000). Finally, there is evidence to suggest that a positive relationship exists between FDI and economic stabilization (Laski 1998).

1.3 FDI incentives in political science

Given the economic growth and development consequences of FDI, it is unsurprising that many states are heavily involved in seeking to attract FDI. As regards the politics associated with FDI incentives, two major explanations exist. The first may be termed the convergence thesis. Due to greater interstate competition for a limited pool of investment capital, states adopt increasing levels of incentives (Guisinger 1985; Stopford and Strange 1991; Thomas 2000). As capital mobility and financial integration have grown over time, especially since the 1960s and 1970s, states have had no choice but to compete with one another to retain existing capital and bring in additional capital. By providing fiscal, financial, or other incentives, states create negative externalities for other states also seeking FDI. In order to compete successfully, states must match the incentives offered by other states. As incentives provision necessitates immediate budgetary consequences, states incur an increasingly limited ability to offer other services. Despite straining

resources to attract investment, MNCs continue to invest as if the incentives did not exist, as the incentives do not make a particular country any more attractive, as all states offer the same incentives.

The second major explanation relies on the distinction between democratic and autocratic political institutions. A country's institutional environment sends signals to investors, especially with respect to property rights protection and policy credibility (Rolfe and White 1992; Rondinelli and Brupitt 2000). A country that maintains stronger economic and political conditions should provide a better investment environment and, by extension, better returns on investment. In order to compensate for worse locational conditions, countries might provide incentives to attract FDI. Li (2006) argues that levels of FDI incentives provision differ between democracies and autocracies because property rights protection and policy credibility vary significantly across the two institutional environments. Democracies feature political institutions that strengthen the rule of law, secure property rights, and make radical policy changes difficult. By contrast, autocracies may characterized as having greater uncertainty with regard to property rights protection and the rule of law, as expropriations and policy changes to the detriment of foreign companies are more common. The logic here is that autocracies must offer more incentives than democracies in order to attract the same level of FDI.

1.4 Question of dissertation

Given the expected positive benefits of FDI, it might be predicted that governments, especially in developing countries, would all provide high levels of FDI incentives. Using data from 18 post-socialist democracies, I show that the evidence does not bear this prediction out. The study of post-socialist countries adds value for a number of reasons. Broadly, the post-socialist cases offer a unique environment in which to consider theories developed in other geographical contexts (King 2000). In particular, analysis of the post-socialist cases adds nuance to existing work on the consequences of the interaction between economic and political regime transitions. In a sense, the post-socialist context acts as a quasi-experimental setting in which to analyze policy choice (Weimer 1997; Frye 2010). All the formerly socialist countries embarked on democratic and market transitions at the same time and started with roughly similar economic characteristics, legacies of the planned socialist economy. These included concentration of property under state control, price controls, and limited availability of domestic capital. In addition, the world economy was quickly globalizing at the moment of post-socialist transition, which had consequences for the post-socialist countries (Dorobantu 2010). In sum, the post-socialist cases provide opportunities for comparative analysis in a quasi-experimental setting.

Figure 1.4 uses data from Cass (2007) and depicts FDI incentives for the 18 post-socialist democratic countries. Following the European Bank

for Reconstruction and Development's (EBRD) methodology, Cass evaluates a variety of factors, including tax rates, tax holidays, tax credits, grants, subsidized locations, and free trade zones. Using this data, Cass builds a composite index of FDI incentives. Higher scores on the Cass index correspond to more generous levels of FDI incentives.

Figure 1.4: FDI Incentives in Post-Socialist Democracies

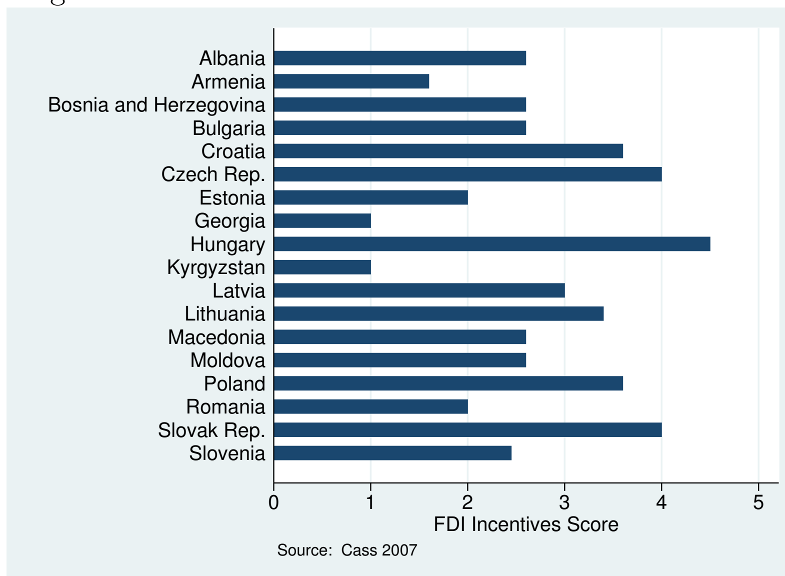
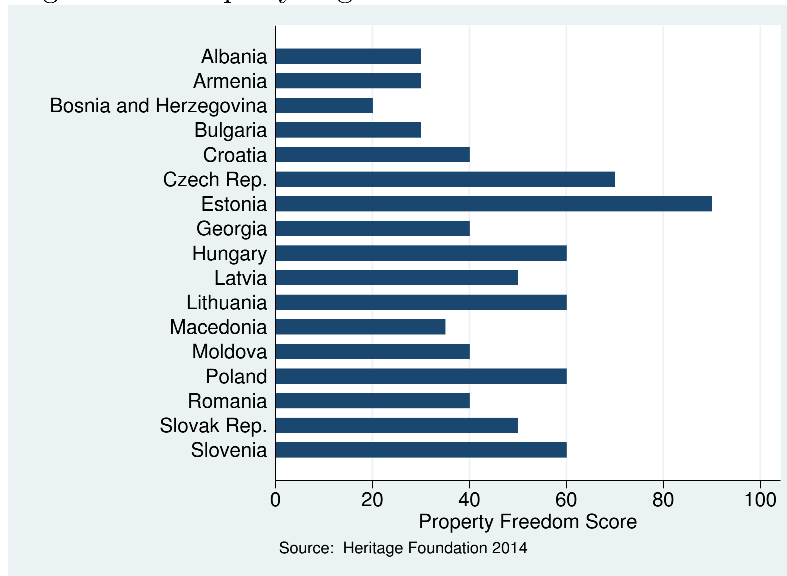


Figure 1.5 employs data on property rights protection from the Heritage Foundation's 2014 Index of Economic Freedom. According to the Heritage Foundation, the property freedom score measures the extent to which a country's laws protect private property rights and the degree to which the country's government enforces such laws. In addition, the property freedom score provides an assessment of the likelihood of expropriation, considers judicial independence and corruption as well as the ability of individuals and busi-

nesses to enforce contracts. A higher score corresponds to stronger property rights protection in a particular country. While property rights protection is not the main focus of my dissertation, it serves as a useful alternative lens through which illustrate government FDI policy.

Figure 1.5: Property Rights in Post-Socialist Democracies

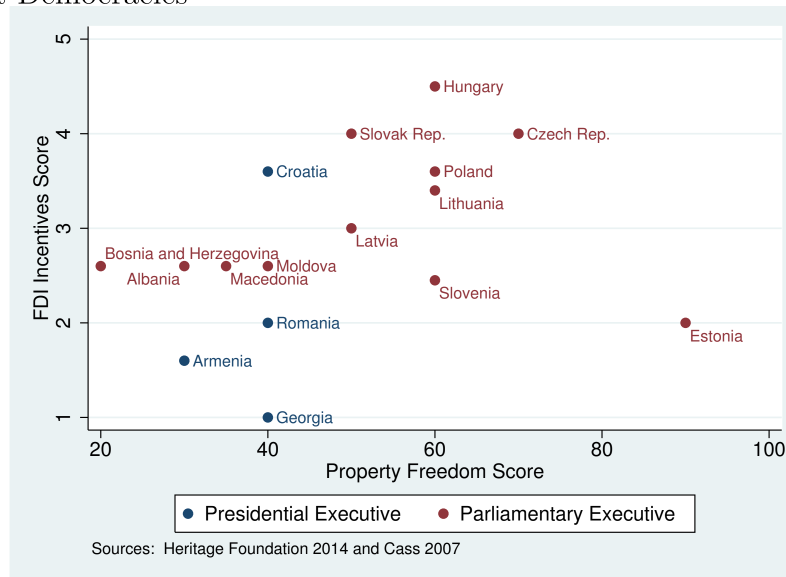


In Figures 1.4 and 1.5, depiction of FDI incentives and property rights protection in post-socialist democratic countries demonstrates significant heterogeneity. This begs the question: if FDI is important for economic growth, why do some democracies provide generous levels of FDI incentives, while others do not?

1.5 Puzzle of dissertation

In seeking to answer this question, an interesting puzzle emerges. It appears that within the subset of post-socialist democracies, a correlation exists between executive regime type and provision of FDI incentives.

Figure 1.6: FDI Incentives, Property Rights, and Executive Regimes in Post-Socialist Democracies



For example, Poland, Hungary, and Slovakia are all parliamentary regimes, while Romania, Georgia, and Armenia are all presidential or semi-presidential regimes. As Figure 1.6 shows, Poland, Hungary, and Slovakia all provide relatively high levels of investment incentives and have high property rights protection scores. On the other hand, countries like Romania, Georgia, and Armenia provide few of these incentives and have low property freedom scores. What might explain why parliamentary democracies offer

more generous FDI incentives than presidential democracies?

1.6 The argument

My answer to this question synthesizes insights from two prominent approaches in the political economy literature. First, I draw on theories concerning the distributional consequences of capital flows. The basic idea here is that trade and factor flows affect the welfare of owners of different factors of production, such as labor and capital (Stolper and Samuelson 1941; Mundell 1957). In line with thoughtful work by Pinto and Pinto (2008), Pandya (2010), Pinto (2013), and Pandya (2014) on the politics of foreign direct investment, I build on the specific factors model of international trade to derive predictions about preferences towards foreign direct investment incentives. I assume a host economy with two industries and three factors. Capital is fixed in each industry, while labor is mobile between the two industries. FDI inflows to one of the two industries affect the returns to both labor and capital across the economy. FDI inflows compete wages up by increasing labor demand, while rents to capital are pushed down. As such, FDI serves as a complement to labor and a substitute for capital. It follows that labor prefers FDI and capital opposes it. I extend this a step further by positing that labor prefers FDI incentives, while capital opposes them. As FDI incentives constitute a budgetary allocation, I assume that FDI incentives are indirect government transfers designed to benefit one group in

society over another.

Second, I adopt the approach taken by Persson, Roland, and Tabellini (1997, 1998b, and 2000) and Persson and Tabellini (2005) for characterizing the differences between parliamentary and presidential regimes in terms of coalition stability and government transfers. Legislative cohesion, which may be used to describe parliamentary regimes, refers to disciplined voting by members of a governing coalition. Parliamentary regimes feature large governing coalitions, which necessarily are more broadly representative. As labor constitutes a greater number of individuals in a society, parliamentary coalitions thus are more representative of labor than of capital. I expect that the preferences of labor are more consistently supported in parliamentary regimes, which implies that parliamentary regimes provide higher levels of FDI incentives.

On the other hand, presidential systems have separation of powers, which can be understood as the requirement that policy changes be approved by a greater number of institutional actors. An important consequence of the presidential system is unstable political coalitions. As a result, FDI incentives beneficiaries must "sell" FDI incentives policy to institutional actors. This means that that the level of FDI incentives provided is lower, because some institutional actors prefer lower levels of incentives compared to other institutional actors. FDI incentives beneficiaries, though, will accept whatever level of incentives is offered. Taken together, this suggests that presidential systems offer lower levels of FDI incentives.

1.7 Plan of dissertation

The rest of the dissertation is as follows. In Chapter 2, I describe the relevant literature on the politics of FDI and the politics of FDI incentives. Having provided the appropriate scholarly context, I characterize my theoretical approach in greater deal and note the central predictions I examine in the quantitative and qualitative portions of the dissertation. In Chapter 3, I present a formal derivation of my theory of the politics of FDI incentives provision. I apply the Baron-Ferejohn legislative bargaining model to substantiate my predictions about how executive regime types condition equilibrium levels of FDI incentives in democracies. Chapter 4 presents cross-national empirical analysis, which utilizes an original dataset of FDI incentives to explore my theoretical predictions.

Chapters 5 and 6 present qualitative evidence from Poland, a parliamentary democracy, and Romania, a semi-presidential democracy. The analyses in these two chapters probe the mechanisms of my theory and provide insight into the politics behind FDI incentives in two formerly socialist, recently anointed European Union (EU) member states. Poland is a particularly interesting case because it was the first post-socialist country to implement radical reforms and adopt a range of measures to establish a market economy (Lewis 1994). The changing political role of the trade union Solidarity from massively popular anti-regime actor to neoliberal regime insider and back again also makes Poland a rich case (Ost and Weinstein 1998).

An archetypal case of protracted post-socialism, Romania has experienced a problematic regime transition and a flawed founding election, which helped former communist-era nomenklatura to remain in power (Crowther 2010). As Gross and Tismaneanu (2005) note, Romania has faced a slower pace of democratization, political instability, and pervasive corruption. These factors help make Romania an interesting contrast to Poland.

Chapter 7 presents analysis of an original dataset of individual level preferences towards FDI incentives in Poland. Chapter 8 concludes and offers directions for future research.

Chapter 2

Theory and literature review

2.1 Introduction

As noted in Chapter 1, FDI has increased rapidly in recent years and is considered to play a major role in economic growth and development. Despite the importance of FDI, countries around the world do not all offer high levels of FDI incentives. In this chapter, I set up discussion of my theory of the politics of FDI incentives provision by first characterizing the politics of FDI and the politics of FDI incentives literatures. Broadly speaking, these literatures have focused primarily on the role of democracy in affecting FDI flows and provision of FDI incentives. Next, I describe my theory of the politics of FDI incentives provision, which draws on two distinct theoretical approaches. I apply the specific factors model of international trade to FDI inflows, following the work of scholars such as Pinto and Pinto (2008),

Pinto (2013), and Pandya (2010, 2014). I also rely on the work of Persson, Tabellini, and Roland (1997, 1998b, 2000) and Persson and Tabellini (2005), who study the policy implications of executive regime types. I then describe equilibrium provision of FDI incentives, in which executive regime type is a key political institution that moderates the translation of preferences towards FDI incentives, as derived from FDI's distributional consequences, into policy.

2.2 Overview of the literature

2.2.1 The politics of foreign direct investment

Scholarly research on the relationship between FDI and politics has grown notably in recent years. In linking investment outcomes to political institutions, one set of explanations focuses on the differences between democracies and autocracies. For some scholars, autocracies are seen as more conducive to FDI because autocratic leaders are less concerned with domestic political pressures and can thus provide more credible commitment to policies beneficial to MNCs (Oneal 1994). According to Li and Resnick (2003), democratic political institutions have three deleterious consequences for FDI. First, democratic constraints on elected politicians tend to weaken the oligopolistic or monopolistic positions of MNCs, potentially also increasing pressure to tax MNCs at higher rates. Second, democratic institutions, such as elections and transparency requirements, prevent host governments

from offering otherwise generous financial and fiscal incentives to foreign investors. Third, broader access to elected officials in democracies and wider political participation offer institutionalized pathways through which indigenous businesses can seek protection from foreign competition.

On the other hand, some have predicted that democracies are better for FDI because they offer lower political risks, which in turn decrease the costs associated with internalizing production (Jensen 2003). Political risks for MNCs that are connected to a host country's regime type include nationalization and expropriation risk; the possibility of unfavorable revisions of tax rates, depreciation schedules, or tariff rates; the imposition of capital controls, devaluations, and unexpected interest rate changes, all of which may affect profitability of investments. As such, democratic institutions may have a positive effect on FDI because democracy provides checks and balances on elected officials, which in turn reduces arbitrary government intervention, lowers the risk of policy reversal, and strengthens property rights protection (North and Weingast 1989; Li 2009). In other words, controls imposed by democratic institutions have the effect of limiting policy uncertainty.

The second major approach in the literature focuses on the role of political constraints, which takes its cue from the transactions costs literature (Williamson 1979). Tsebelis (1995, 2000) defines these political constraints as veto players. According to veto players theory, fundamental political differences between countries are closely connected to the number of individual or collective actors whose agreement is necessary for a change to the status

quo. As Henisz (2000a) notes, frequent and potentially arbitrary changes in economic policies increase investor uncertainty and raise hurdle rates for private investment. In addition, institutional environments in which economic returns can easily be secured through political channels leads individuals to reallocate resources from economic to political activities. Once an investment has been made in a country, it is often costly to withdraw. As such, investors are particularly concerned about policy changes after assets have been deployed abroad. In countries where governments are significantly constrained from policy changes by political institutions, such as those with a greater number of veto players, investors are more comfortable making investments (Henisz and Williamson 1999; Henisz 2000a, 2000b).

Another treatment of the politics of FDI examines the link between investment and politics through the lens of class conflict. According to the most prominent account in this approach, known as the triple alliance hypothesis, host governments, domestic businesses, and foreign capital collude in order to exploit workers (Evans and Gereffi 1982). The prediction here is that domestic business owners would support foreign investment inflows as contributing to their strength, while workers would oppose foreign investment and the costs it brings for worker political strength. My approach relies on evidence to the contrary, namely that labor is a more consistent supporter of FDI than domestic capital. In addition, the alliance between domestic and foreign capital has proven to be unstable and short-lived, when it has existed (Dominguez 1982).

A fourth explanation characterizes FDI as footloose capital, which may negatively affect labor via economic insecurity and income volatility (Scheve and Slaughter 2004). As economic production has become increasingly globalized, MNCs have greater access to foreign factors of production and thus an enhanced ability to substitute away from workers in any particular geographic location. The result is that workers feel more insecure because FDI increases a company's elasticity of demand for labor. As labor demand elasticity increases, wage and employment volatility also increase, which raises worker insecurity. As Pinto (2013) suggests, though, FDI implies a flow of capital with management responsibility and often involves fixed, illiquid assets. This indicates that FDI is less footloose than portfolio investment, for example. In other words, while the threat of exit of FDI from a particular market is real, greater barriers exist as regards exit compared to other forms of financial flows.

In post-socialist countries, scholars have adopted a few different perspectives to explain the politics behind FDI inflows. On one hand, some accounts rely on purely domestic factors. Beyer (2000) suggests the effectiveness of authorities responsible for privatization and low tax levels have positive effects on FDI inflows, while a larger number of veto players is detrimental. Carsten and Toubal (2004) argue that country risk factors, such as political uncertainty and instability are important deterrents of FDI. Other explanations of FDI inflows to post-socialist countries apply theories with a stronger international focus. Bandelj (2008) draws on constructivist views in

suggesting that FDI inflows to Central and Eastern Europe should be viewed as a socially constituted relational process, negotiated by practical economic actors. In this account, the relational nature of FDI suggests that investment flows are shaped not only by the host country's economic and political characteristics, but are channeled through the existing network of social relations between countries. Drahokoupil (2008) argues that the pressures of the transnational environment on FDI inflows should not be overstated, as these factors need to be translated by domestic actors. In particular, Drahokoupil suggests that international factors have encouraged the development of so-called "competition states" in Central and Eastern Europe. The competition state, in effect, promotes FDI-friendly policies and puts downward pressure on wages and taxes.

In light of rising income inequality around the world, scholars have begun to more closely examine the relationship between FDI inflows and inequality. According to Bradley et al. (2003), the literature on the drivers of income inequality can be divided into two approaches. First, it can be argued that income inequality is a product of domestic factors, such as labor markets and political institutions. Second, inequality may result from a greater elasticity of demand for labor, as globalized capital can credibly threaten to relocate from a host country elsewhere. Studies of the impact of FDI inflows on income inequality have returned mixed results. Jensen and Rosas (2007) focus on capital inflows to Mexico from 1990 to 2000, finding that Mexican states that attracted higher levels of FDI enjoyed lower

income inequality relative to states with less FDI inflows. On the other hand, Reuveny and Li (2003) test the impact of FDI on income inequality on 69 countries from 1960-1996, concluding that FDI increases inequality. Mihaylova (2015) studies data from ten post-socialist countries in Central and Eastern Europe, noting that the effect of FDI on income inequality depends on levels of economic development and human capital. The effect of FDI inflows on income inequality likely has consequences for demand for FDI and FDI incentives. yet significant uncertainty remains about the nature of the relationship between FDI and inequality.

2.2.2 The politics of FDI incentives

According to Dunning (1988), MNCs make decisions about foreign investments according to the OLI framework, which consists of three dimensions: ownership, location, and internalization. Ownership means that firms engage in FDI projects because of characteristics specific to the company, such as intangible assets, technological capabilities, or product innovation. Internalization means that a firm draws upon its capacities in order to coordinate activities internally in the value-added chain, as opposed to licensing or conducting a joint venture. Location means that firms exploit institutional and productive factors of the target setting. As such, FDI incentives fall under the location dimension of the OLI framework.

MNC decisions to invest abroad are affected by the locational characteristics of the host country. These include factor endowments, level of eco-

nomic development, macroeconomic conditions, and political context (Dunning 1988; Caves 1996). Incentives to attract foreign investors can be seen as direct government intervention in capital markets, which affects the allocation of scarce financial resources, influences government revenues, and favors particular groups at the expense of others (Antaloczy, Sass, and Szanyi 2011). More explicitly, Li and Resnick (2003) suggest that investment incentives represent a transfer of benefits from domestic taxpayers to foreign investors. Other accounts, such as the one I propose below, present FDI incentives as indirect transfers to the domestic beneficiaries of FDI.

Some scholars posit that FDI promotion programs can cause rent-seeking behavior when governments directly pick winners and losers in the market, discriminate against small and local firms, and design incentives programs without sufficient input from a broad array of domestic stakeholders. Insofar as MNCs pursue monopolies, incentives may strengthen this impulse and ability to monopolize host markets (Moran 1999). Those who benefit from FDI incentives may then use their political power to affect the policy process, turning FDI incentive programs into the objects of political conflict.

Existing explanations of the politics of FDI incentives fall into two main categories. One approach relies on the convergence thesis. In this view, governments have increasingly chosen to adopt incentive programs under conditions of intensifying competition among national governments for limited investment capital (Guisinger 1985; Stopford and Strange 1991; Thomas 2000). With increasing capital mobility and financial integration, governments have

had to compete with one another to keep existing capital and attract additional capital. In order to attract a mobile factor of production such as FDI, one government might expand use of a policy instrument that increases the rate of return to that mobile factor, such as corporate tax exemptions, deployment of investment promotion agency resources, or direct subsidies to companies. These policy changes create negative externalities for other states competing for the mobile factor.

From the perspective of game theory, this resembles an n-person "Prisoner's Dilemma" in which every government has a dominant strategy of seeking to make its market more attractive than its neighbors' markets (Thomas 2000). In the game's suboptimal equilibrium outcome, the mobile factor remains distributed as before, but all countries and their citizens are worse off because the costs associated with providing tax exemptions, funding investment promotion agencies, or paying subsidies are not balanced by the benefits of increased investment. On the other hand, the owners of the mobile factor of production reap increased rewards.

Another explanation focuses on how democratic or autocratic political institutions affect a country's provision of FDI incentives. According to Shah and Toye (1978), tax incentives may affect investment via the "illusory compensating effect." For host countries that lack proper infrastructure, updated technology, and natural resources, offering generous incentives to attract FDI might be a way to compensate for these weaknesses. However, the compensating effect of incentives is not merely economic. Janeba (2002) argues that

countries with low credibility are not attractive hosts for FDI and so governments in these countries offer incentives to make up for the credibility gap. The host institutional environment also sends a signal to investors, particularly regarding the extent of property rights protection and government policy credibility. Host countries with better economic and political locational conditions provide a better investment environment and therefore higher returns. In order for host countries with more attractive locational characteristics to successfully attract FDI, governments need not offer the same levels of incentives as countries with worse locational conditions. As such, weak property rights protection and low policy credibility in a country are predicted to be associated with generous incentives to attract FDI.

Li (2006) builds on this approach by examining the differences between democracies and autocracies with regard to FDI incentives provision. Put simply, democracies and autocracies offer different levels of FDI incentives because they differ significantly with regard to property rights protection and policy credibility. As FDI usually entails fixed costs and challenges in relocating an investment once made, foreign investors face higher costs in terms of monitoring and enforcing property rights (Frieden 1994). One consequence of this is declining bargaining power for foreign investors vis-a-vis host governments over time, potentially exposing foreign investors to expropriation, contract issues, and corrupt bargains (Kobrin 1988). Democratic political institutions, such as a constrained executive, an independent judiciary, and an open civil society, work together to strengthen the rule of law and secure

property rights. With the power of leaders constrained, democratic political institutions also permit diverse interests to gain political representation, and raise the costs of providing private benefits, which make a state's commitment to the rule of law more credible (North and Weingast 1989).

Insofar as the rule of law in democracies entails policy credibility and stronger property rights protections, democratic countries may offer lower levels of incentives to be equally attractive locations for FDI as autocratic regimes. Assuming that FDI incentives are contracts between host governments and foreign investors, Li (2006) finds additional support for the prediction of lower FDI incentives in democracies and higher FDI incentives in autocracies. In line with the bargaining model in international business (Kobrin 1987), a better institutional environment gives host governments more bargaining power with respect to foreign investors. As more democratic countries usually have stronger property rights protections and policy credibility, investors expect governments in these countries to uphold agreements they make (Simmons 2000). This translates into greater bargaining power on the part of governments in democratic countries, which implies that these governments need not offer higher levels of incentives to attract investments. A second reason why this prediction finds support is that because contract risks are lower in democratic countries, risk adjusted returns from incentives contracts should be higher for investors, given the same level of incentives. As a result, investors see lower levels of incentives in democratic countries equally as attractive as higher levels of incentives in autocratic countries.

2.2.3 Problems with the literature

A crucial takeaway from this review of the politics of FDI and the politics of FDI incentives literatures is that certain aspects of domestic politics have been largely ignored. As Pinto (2013) notes, globalizing forces, degree of democracy, and level of institutional constraints are indeed important determinants of FDI flows, but because FDI has domestic distributional consequences, the literature needs to include a greater focus on domestic politics.

Specifically, Li's (2006) article elicits concerns. First, Li assumes that democracies are homogenous for the purposes of analysis, which is a significant assumption, but one shared by many prominent scholars, such as Przeworski et al. (2000). However, others such as O'Donnell (1994), Zakaria (1997), Levitsky and Way (2002), and Smith and Ziegler (2008) suggest that democracies come in a variety of shapes and sizes, some of which are more or less autocratic than others. It follows that consideration of differences across the set of global democracies should be examined more carefully.

In particular, the set of post-socialist democracies has had unique trajectories due to the recent past. In furthering ideas about legacies, Ekiert (2003) contends the impact of communism was greatest on specific paths of reform and types of transformations during the first post-socialist decade. Pop-Eleches (2007) argues for the importance of historical legacies in studying the post-socialist countries, while acknowledging that structural conditions alone have not predetermined outcomes in these countries. For example, those post-socialist countries with favorable legacies, such as longer

histories of statehood, democracy, and bureaucratic competence, have had different experiences with democracy than countries with less favorable legacies. Mishler and Rose (1997) note one particularly distinctive feature in post-socialist countries, the virtual absence of positive trust in political institutions. Though healthy skepticism is said to facilitate democratic society more than blind trust, the overall pattern in post-socialist countries is one of severe skepticism that borders on outright distrust of political institutions. The point here is that the legacies of communism help to differentiate the post-socialist democracies from each other as well as democracies in other regions. This calls into question Li's assumption about the homogeneity of global democracies.

Second, Li assumes that domestic political institutions within democracies, such as executive regime type, are unrelated to government spending on FDI. Persson et al. (1997, 1998, 2000) and Persson and Tabellini (2005) have noted, both theoretically and empirically, that a country's executive regime type has consequences for the level of domestic spending. In the theory of the politics of FDI incentives provision I detail below, I seek to address the lack of focus in the literature on domestic politics by taking into account domestic distributional consequences and the impact of executive regime type on the level of FDI incentives offered by democratic governments.

2.3 Theory

In this section, I outline my theory explaining the underprovision of FDI incentives by democratic presidential regimes and the more generous provision of FDI incentives by democratic parliamentary regimes. The theoretical framework I propose here draws on Rodrik (1995) to analyze the demand and supply conditions of economic policy making. On one hand, individual preferences and related incentives to organize politically constitute the demand side of policymaking. On the other hand, the interaction between politicians' objective function and the incentives created by political institutions constitute the supply side of politics. The ultimate policy outcome depends on politicians' ability to effect policy changes, which is a function of institutions that regulate policymaking. To achieve the equilibrium policy, demand and supply conditions must intersect. Individual preferences, aggregated through politically relevant collective actors, interact with politicians' objective function in the right institutional setting to produce the policy. I first describe demand for FDI incentives before turning to supply of FDI incentives. The section concludes with a characterization of equilibrium FDI incentives provided in both presidential and parliamentary democracies.

2.3.1 Demand for FDI incentives

In characterizing demand for FDI incentives, I follow a common strategy employed in the political economy of trade literature, which relies on expected

returns to factors of production, namely labor and capital. As a baseline, I assume that economic agents are rational, forward-looking and seek to maximize the present value of their expected income. In the political economy of trade literature, the idea that trade and factor flows impact the return of owners of factors of production is well accepted (Stolper and Samuelson 1941; Mundell 1957).

In the political economy of trade literature, scholars such as Rogowski (1989) have examined how relative factor intensities affect the political pressures for and against free trade. In countries with high labor-to-capital ratios, meaning that capital is the scarce factor, workers are expected to favor free trade, while capital owners tend to favor protection. This is because workers benefit from the export of labor-intensive goods and the import of inexpensive capital goods under free trade, while capital owners benefit from higher prices of capital goods under protection.

Recent work has adopted the returns to factors approach and applied it to the politics of FDI. For example, Pinto and Pinto (2008) and Pinto (2013) examine the existence of partisan cycles in FDI performance. These scholars predict that an incumbent government's partisanship affects foreign investors' decisions: pro-labor governments encourage inflows of the type of investment that complements labor in production, while pro-capital governments promote the entry of investment that substitutes for labor. Pandya (2010) argues that FDI preferences are a function of FDI's distributional effects, in particular that labor supports FDI inflows and that this support

is greater among individuals with high skill levels. Most recently, Pandya (2014) suggests that FDI's distributional consequences and a country's level of democracy help to explain why politicians chose whether or not to restrict foreign ownership. In this view, politicians choose foreign ownership regulations when they privilege the interests of a narrow elite, while they support liberalization when there are political incentives to raise incomes for a broad range of people.

Following these scholars, I apply the specific factors model of international trade to FDI inflows in order to derive distributional consequences for groups within an FDI host country. According to the theoretical and empirical literature on FDI, workers tend to benefit from FDI inflows (Lipsey and Sjoholm 2004; 2005), while the return to domestic capital in the host country tends to fall (Haddad and Harrison 1993; Aitken et al. 1996; Feenstra and Hanson 1997; Aitken and Harrison 1999; Feliciano and Lipsey 1999; Figlio and Blonigen 2000; Lipsey and Sjoholm 2005). By way of FDI, MNCs hire local workers and introduce more efficient production technologies that increase labor productivity. Wages tend to be higher in foreign firms. On the other hand, host country businesses face higher production costs due to greater labor demand.

Consider a host country economy with two industries and three factors. Capital is specific to each industry, while labor is mobile across the two industries. FDI inflows increase the supply of productive capital in one industry, while the supply of productive capital in the other industry remains

fixed. Given a certain technology that determines the ability of the foreign investor to complement either factor of production, an inflow of FDI affects the returns to labor and capital in the host country across the two industries. When an inflow of FDI competes wages up by increasing labor demand and thus pushes rents down, labor favors foreign investment and capital opposes it. Assuming that FDI complements labor, labor prefers greater FDI inflows. By contrast, because FDI substitutes for domestic capital, domestic business owners oppose FDI. A consequence of increasing returns to labor and decreasing returns to capital is a decrease in income inequality in the host country. This occurs because the income of labor rises with increased demand induced by FDI inflows, while the income of capital declines because a greater portion of rents have to be paid to labor as wages. The result is a speeding up of the convergence of the incomes of labor relative to capital.

I posit that while FDI incentives do not directly benefit workers, they can be considered resource allocations or government transfers designed to favor one constituency, workers, over another constituency, domestic capital owners. It follows, then, that those actors who may be harmed by FDI would seek to limit FDI inflows and thus would not be in favor of FDI incentives, while those who would benefit from FDI inflows would support FDI incentives.

With preferences defined, I make the assumption that individual workers and individual owners of capital are able to overcome the collective action problem to advocate as groups for their preferred policies. For workers, labor

unions are the primary vehicle for accomplishing this, while business associations provide the solution to the collective action problem for domestic capital.

2.3.2 Supply of FDI incentives

In explaining supply of FDI incentives, I begin by examining the motivations of individual politicians. Why do democratic politicians behave the way they do? Following the logic of Buchanan (1989), I assume that politicians, like all individuals, seek to further their own narrow self-interest. As Besley (2004) notes, the most basic self-interest for a politician in a democracy is re-election. From a simple perspective, democracy entails a principal-agent relationship between the electorate and politicians. The electorate (the principal), in essence, delegates authority to politicians (agents) on policy matters. What happens if politicians act contrary to the interests of the electorate, thus creating a moral hazard? In democracies, situations of moral hazard are addressed via the reelection mechanism. If politicians do not do their jobs as per the requirements of the electorate, voters "throw the bums out." Put otherwise, self-interested politicians behave in the interests of voters because if they do not, they lose their jobs.

Democratization, which expands societal political participation, plays an important role with respect to the politics of FDI incentives. Buena de Mesquita et al. (2009) define the "selectorate" as that subset of a country's population that has political voice and define "winning coalition" as the

proportion of the electorate whose support is sufficient for leaders to remain in power. When a country democratizes, the size of both the selectorate and winning coalition increase, which requires politicians to gain the support of a larger proportion of the population, as compared to conditions under autocratic rule. As such, the larger selectorate under democracy gives labor more political influence as compared to autocracy.

Political institutions, particularly executive regimes, play an important role in shaping the level of FDI incentives. In his typology of majoritarian and consensual democracies, Lijphart (1999) articulates two key dimensions, the executive-parties dimension and the federal-unitary dimension. The contrasts noted in Lijphart's executive-parties dimension, in particular, help to highlight differences between the two major types of executive regime, presidential and parliamentary. In parliamentary systems, which generally have executive power sharing across parties, relative balance between executive and legislative branches, multiple parties, proportional representation, and corporatist interest groups, politicians are under pressure to form larger coalitions to gain and remain in power. By contrast, presidential systems feature concentrated executive power, a dominant executive vis--vis the legislative branch, a two-party system, majoritarian and disproportional electoral systems, and pluralist interest group systems. This structure is less conducive to large, stable coalitions.

Stepan and Skach (1993) provide a rich description of the differences between presidential and parliamentary regimes, which helps to highlight how

each system conditions coalition formation. As they put it, the essence of a pure presidential regime is mutual independence. This means, among other things, that there are few incentives for coalitional cooperation. The office of the president is indivisible and while the president may select members of other parties to serve in her cabinet, they are selected as individuals and not as members of an enduring and disciplined coalition. A president may ultimately be able to advance her legislative agenda by cajoling or purchasing a legislative majority, but repeated majorities will be difficult to obtain. On the other hand, Stepan and Skach characterize a pure parliamentary regime as a system of mutual dependence. Under a parliamentary regime, the incentive structure is such that creating and maintaining single-party or coalitional majorities is encouraged.

Over the course of a number of scholarly works in the late 1990s and early 2000s, Persson, Roland, and Tabellini developed a series of formal models to characterize the differences between presidential and parliamentary regimes with regard to coalitional stability and government transfers. In explaining coalition stability under different regimes, Persson, Roland, and Tabellini (1997, 1998b, 2000) and Persson and Tabellini (2005) employ two key theoretical concepts, separation of powers and legislative cohesion. Separation of powers between legislative and executive authority means more institutional actors that must be satisfied for a policy to be approved. Persson et al. (1998b) note that separation of powers allows the design of a system of checks and balances that fulfills two conditions. First, there is a conflict

of interests between the executive and the legislature. Second, legislative decision-making requires joint agreement by both bodies. One consequence is that policy coalitions are unstable in presidential systems. This means that the beneficiaries of FDI incentives have to successfully "sell" FDI incentives policy to institutional actors.

In the simplest case, where the institutional actors include only a president and parliament, this setup resembles a duopsony. In other words, the beneficiaries of FDI incentives (i.e. workers) sell the FDI incentives policy to the two institutional "buyers," the president and parliament. The president and parliament, however, have different preferences over spending on FDI incentives. Because the president represents the entire country, she bears the full cost of the FDI incentives policy. This implies that she has a lower appetite for spending. By contrast, each individual legislator only bears a fraction of the cost. In other words, if the cost of the FDI incentives policy is $1 million and the legislature has 100 representatives, each representative's district only bears 1/100 of the cost ($10,000) but receives the full benefit of FDI incentives. As a result, the legislature prefers a higher level of spending. Because the beneficiaries of FDI incentives need the institutional actors to agree on the "price" of FDI incentives, the FDI incentives are priced at the lower level preferred by the president. In sum, FDI incentives are offered at a lower level in presidential regimes

Persson et al. (2000) employ the idea of legislative cohesion, originally developed by Diermeier and Feddersen (1998) to characterize parliamentary

regimes. Legislative cohesion refers to disciplined voting by members of a governing coalition. This arises when it is costly for a majority coalition to break up, for instance, because it loses valuable agenda-setting powers associated with being in power. The result is that the governing coalition has strong incentives to vote together on proposed legislation. One of the features of parliamentary regimes is the power to associate a vote on a bill with a vote of confidence on the entire governing coalition. Coalition partners, who fear the risk of losing the agenda setting power associated with being in the governing coalition, have strong incentives to form a stable majority that does not shift from issue to issue (Diermeier and Feddersen 1998). Under parliamentary regimes, however, higher provision of government transfers and thus higher tax rates occur because the equilibrium transfer policy must be jointly optimal for all voters represented in the governing coalition. There are more voters represented in the governing coalition in a parliamentary regime as compared to a presidential regime, because parliamentary governing coalitions are larger. In turn, all partners in the governing coalition have strong incentives to collude given the significant costs of losing the agenda-setting position under non-cooperation.

2.3.3 Equilibrium FDI incentives

The type of executive institution, either presidential or parliamentary, affects the supply of FDI incentives. In presidential regimes, which feature separation of powers, politicians are not motivated to form stable coalitions.

As a result, workers must bargain with institutional actors to obtain FDI incentives, which drives down the level of incentives provided.

In parliamentary regimes, which are characterized by legislative cohesion, politicians have greater incentives for collusion because the vote of confidence mechanism provides the potential for premature coalition dissolution. As a result, the large, stable coalitions in parliamentary systems must satisfy a larger number of constituents in the interest of maintaining stability. Because labor outnumbers capital, parliamentary coalitions support policies that benefit labor to a great extent. It follows that higher levels of FDI incentives are supported in parliamentary systems, to the benefit of a large portion of the population.

2.4 Conclusion

In this chapter, I set the stage for the introduction of my theory of the politics of FDI incentives provision by characterizing the relevant literatures on FDI and FDI incentives. After identifying gaps in the extant literature, I present my theory. I first argue that FDI inflows have distributional consequences, namely that labor benefits from FDI inflows and FDI incentives, while capital is hurt by FDI inflows and FDI incentives. I then posit that, within democracies, the type of executive regime moderates the translation into policy of FDI incentives preferences. Due to variation in coalition stability, parliamentary systems provide generous levels of FDI incentives, while

presidential systems provide lower levels of FDI incentives. In Chapter 3, I formalize my theoretical approach using the tools of game theory. I derive testable hypotheses, which I subsequently examine in the cross-national empirical analysis of Chapter 4. The post-socialist case studies presented in Chapters 5 and 6 allow me to dig deeper into the mechanisms underpinning my theoretical approach. Simultaneous political and economic transformations as well as intensification of globalization around the moment of transition make the post-socialist cases particularly worthy of examination.

Chapter 3

A political economy model of FDI incentives

3.1 Introduction

In Chapter 2, I characterize the literature on the politics of FDI and FDI incentives, identifying gaps that merit further analysis. I suggest that the politics of FDI incentives literature, in particular, would benefit from a greater focus on domestic politics. In particular, the literature overlooks heterogeneity among democracies and the impact of political institutions, namely executive regimes, in explaining the provision of FDI incentives. I address these issues by combining theories concerning the distributional consequences of FDI inflows and the policy effects of executive regime types to build a theory of the politics of FDI incentives provision. My theory pre-

dicts that parliamentary democracies, characterized by legislative cohesion, provide generous levels of FDI incentives. On the other hand, I predict that presidential democracies, which feature separation of powers, do not provide generous levels of FDI incentives.

For the purposes of this chapter and the empirical analysis in Chapters 4, 5, and 6, I make an important assumption about differences between parliamentary and presidential democracies. As noted above, I characterize parliamentary democracies as featuring legislative cohesion and presidential democracies as having separation of powers. In the interest of facilitating the derivation of testable hypotheses in this chapter and examining these hypotheses in the subsequent empirical chapters, I assume that parliamentary and presidential democracies can be both located on a continuum of legislative cohesion. Parliamentary democracies, which feature the vote of confidence mechanism that encourages stable coalition formation, have high levels of legislative cohesion. At the opposite end of the legislative cohesion continuum, presidential democracies have conflicting interests, which results in unstable coalitions. Compared to parliamentary democracies, legislative cohesion is lower in presidential democracies.

In this chapter, I present a formal derivation of the logic behind my theory of the politics of FDI incentives provision. Using the tools of game theory, I derive a testable hypothesis relating directly to my main theoretical prediction, that higher levels of legislative cohesion in parliamentary systems leads to higher provision of FDI incentives. I also derive a second testable

hypothesis examining the interaction effect of FDI inflows on my main theoretical prediction. This hypothesis suggests that the interaction between legislative cohesion and FDI inflows leads to lower provision of FDI incentives.

The rest of the chapter proceeds as follows. I first characterize the legislative bargaining framework that underpins my model by way of a brief literature review. I then present models for parliamentary and presidential regimes, examining the effect of legislative cohesion on equilibrium provision of FDI incentives. For each model, I describe the actors and their available actions, before presenting actor utilities. Next, I describe the order of play before moving to a discussion of the equilibrium solution concept and equilibrium. I then conduct simple comparative statics exercises on each model. This process allows me to demonstrate how the mechanisms of legislative bargaining in each executive regime and the consequences of legislative cohesion influence equilibrium levels of FDI incentives provided. I then present a testable hypothesis derived from this approach.

The next set of models focuses on how FDI inflows interact with legislative cohesion to influence the equilibrium provision of FDI incentives in parliamentary and presidential regimes. As the legislative bargaining process remains the same as in the first two models, I focus only on the utility consequences of FDI inflows for actors in each executive regime type. For each of the two models, I describe the actors and their available actions, before presenting actor utilities. After deriving equilibrium levels of FDI incentives,

I then conduct simple comparative statics exercises, which allow me to characterize the specific role of FDI inflows. I also present a testable hypothesis based on conclusions drawn here. I then sum up results from the analysis in a concluding section.

3.2 Legislative bargaining over FDI incentives

The approach I use in this chapter draws on Baron and Ferejohn's (1989) seminal model of policy choice in small groups, which they describe as "legislative bargaining." Baron and Ferejohn, in turn, build upon Rubinstein's (1982) model of two-player bargaining. As McCarty and Meirowitz (2007) describe it, Rubenstein's model postulates that two players seek to decide how to divide $1. The players take turns making offers, meaning that player 1 makes proposals in periods 0, 2, 4, 6,...N, while player 2 makes proposals in the other periods. Until a proposal is accepted by the other player, the game continues. One key feature of the Rubinstein model is that in order for agreement on allocation to be reached, unanimous consent is required. As it were, this approach eliminates a number of important political settings where only a simple majority or supermajority is required for agreement. The key move by Baron and Ferejohn (1989) was to extend the basic Rubinstein model to a simple majority rule with three or more bargainers.

As Gehlbach (2013) notes, Baron and Ferejohn (1989) consider a single policy problem, which concerns the distribution of a resource among a

legislature governed by majority rule. This resource is rival and excludable. According to social choice theory, there is no Condorcet winner in this environment if the number of legislators is three. In other words, collective preferences can be non-transitive, even if individual preferences are transitive. However, as the Rubinstein and Baron-Ferejohn models show, with a small number of restrictions on the set of equilibria, it is possible to characterize the nature of the equilibrium policy chosen by the collective.

The Baron-Ferejohn model has been generalized and applied to a number of important questions in political science and economics. Chari et al. (1997) use the model to analyze split-ticket voting and government spending under different democratic executive regimes, arguing that overall spending is too high only if a president's powers are limited. These authors suggest that overall spending is always high in a parliamentary system, relative to a presidential system. Eraslan (1999) uses the model to study corporate bankruptcy and focuses particularly on how surplus resources, after initial bargaining, are allocated among negotiating partners. A class of two-level models by Iida (1996) and Mo (1994) examine international agreement ratification using Baron-Ferejohn models. Tarrar (2001) extends these models and finds that whether domestic constraints benefit an executive in obtaining agreement ratification can depend crucially on whether the other executive is also constrained. Tarrar (2005) then uses Baron-Ferejohn models to examine international agreement ratification across presidential and parliamentary executive regimes. To my knowledge, the models presented in this chapter

are the first to analyze FDI incentives using the Baron-Ferejohn framework.

The basic setup for the models draws on Weingast et al. (1981), Chari et al. (1997), and Baqir (2002). In the models presented in this chapter, the resource to be distributed is a shared tax base. As noted above, I assume that FDI incentives are indirect redistributive transfers to a particular group in society. For the remainder of the chapter, I refer to these transfers as spending on FDI incentives.

Since the individual legislator's district bears only a fraction of the cost of spending on FDI incentives, each legislator has an incentive to overspend. This is the case for legislators in both parliamentary and presidential regimes. On the other hand, the executive's district bears the full cost of the FDI incentives spending, which implies that the executive lacks the same incentive to overspend as the legislator. Actors bargain in the context of a simple one-period legislative "ultimatum game," in which the agenda setter makes a take-it or leave-it offer to the other actors. In both executive regimes, the agenda setter is a member of the legislature. I assume also that both regime types throughout are democracies.

3.3 Baseline models: parliamentary and presidential regimes

3.3.1 Parliamentary regime

Actors

Assume there are N legislators bargaining over a divisible resource $x \geq 0$, which here is taken to mean spending on FDI incentives. When presented with a proposal x_i, each legislator can either accept or reject the proposal.

Actor utilities

All legislators are assumed to have complete information. Spending on x provides each legislator with benefits according to the function *g(x)*. Assume also that *g(x)* satisfies the following conditions (Inada 1963):

1. The value of the function $g(x)$ at 0 is 0, i.e. $g(0) = 0$.
2. The function is continuously differentiable.
3. The first derivative of $g(x)$ is $g' > 0$. This implies that the function is strictly increasing in x.
4. The second derivative of $g(x)$ is $g'' < 0$, which implies that the function is concave with a global maximum and decreasing marginal returns.
5. The limit of the first derivative is positive infinity as x approaches 0, i.e.

$g'(0) = \infty$.

6. The limit of the first derivative is 0 as x approaches infinity, i.e. $g'(\infty) = 0$.

In order to pay for x, legislators use tax revenue. Assume that taxation of constituents imposes a constant marginal cost of unity on each legislator. This means that each legislator pays the same, constant amount for extracting this tax revenue. Each legislator represents an equal-sized constituency, such that her constituents only need to pay $\frac{x}{N}$ of the cost. The a term denotes legislative cohesion, which represents the effects on coalition stability associated with different executive regime types. The multiplicative term ax represents the impact of legislative cohesion on a particular aspect of government spending, FDI incentives. I assume $a > 0$. By including the ax term in each actor's utility function, I ensure the institutional effects of legislative cohesive play a key role in the subsequent bargaining games.

I define the utility of each legislator $i \in 1, 2, ..., N$ as

$$u_i(x) = g(x) - \frac{x}{N} + ax \tag{3.1}$$

I proceed under the assumption that each legislator has quasi-linear utility, which implies that her utility is strictly quasi-concave in x and that a unique ideal point exists for each legislator, where marginal benefits equal marginal costs.

What is each legislator's preferred level of x ? I proceed by maximizing u_i.

$$\max_x g(x) - \frac{x}{N} + ax$$

The first order condition for this maximization problem is given by

$$g'(x) - \frac{1}{N} + a = 0 \tag{3.2}$$

In order to solve for x, I first isolate $g'(x)$

$$g'(x) = \frac{1}{N} - a$$

I then apply the inverse of g' to both sides of the equation

$$g'^{-1}(g'(x)) = g'^{-1}(\frac{1}{N} - a)$$

Simplifying the left hand side, I obtain

$$x_i = x_L = g'^{-1}(\frac{1}{N} - a) \tag{3.3}$$

<u>Order of play</u>

In order for x to pass, the proposal needs the support of $n = \frac{N+1}{2}$ votes. The agenda setter is the representative of a majority of the legislators, such as the prime minister. The agenda setter makes a take-it or leave-it offer to the current legislative session, which is considered bargaining under a "closed

rule." This basically means that no amendments can be made to the proposal. After the legislature decides to accept or reject the proposal in this single period, the game is over. The order of play is as follows:

1. The agenda setter proposes x_1.
2. The legislature chooses to accept or reject x_1. If the legislature accepts, x_1 is implemented. If the legislature rejects x_1, a status quo policy x_s is implemented, where $x_s < x_L$.
3. The game ends.

Equilibrium solution concept and equilibrium

The equilibrium solution concept I use here is subgame perfect Nash equilibrium (SPNE). This means that each legislator plays Nash, meaning that she provides a best response to a best response in each subgame of the overall game. I characterize the SPNE to this game using the usual backwards induction method. If the agenda setter proposes $x_1 < x_L$, she knows that the legislature will reject it. In addition, the agenda setter would not propose any $x_1 < x_L$ because this would fail to satisfy her own utility. As a result, the agenda setter will propose $x^*=x_L$, which the legislature approves by majority rule. In equilibrium, where P stands for parliament, then:

$$x^*_P = x_L \tag{3.4}$$

Comparative statics

To examine the effect of legislative cohesion of equilibrium levels of FDI spending, I conduct a simple comparative statics exercise. Taking equation 3.3, I maximize with respect to a, the legislative cohesion parameter. Note that in light of the Inada conditions assumed earlier, g' is positive.

$$\max_a g'^{-1}(\frac{1}{N} - a)$$

By the chain rule, and because of the properties of $g(x)$ enumerated above, it follows that

$$-g''^{-2}(-1) > 0$$

As assumed in the Inada conditions, g'' is negative. This reduces to

$$g''^{-2} > 0 \tag{3.5}$$

As equation 3.5 shows, the effect of increasing legislative cohesion is positive.[1] In other words, increasing levels of legislative cohesion have the effect of increasing the equilibrium level of FDI spending in the context of parliamentary regimes.

[1] Equation 3.5 indicates that the first derivative of the equilibrium result in equation 3.3 is positive. In other words, the effect of the legislative cohesion term a has a positive effect on the level of FDI incentives spending x.

3.3.2 Presidential regime

Actors

Assume now that there are N legislators and an independent executive bargaining over the divisible resource $x \geq 0$, spending on FDI incentives. Individual legislators can accept or reject the proposal x. Once the proposal is approved by the legislature, the legislative agenda setter presents the proposal to the independent executive, who can accept or reject it. All actors have complete information.

Actor utilities

Individual legislator utilities are identical to those described in the parliamentary regime. For the executive's utility, assume that the Inada conditions hold and that the executive has quasi-linear utility, meaning that her utility is strictly quasi-concave in x and that a unique ideal point exists for her. The executive holds the power of veto and represents the entire country. In presidential regimes, legislative cohesion a also impacts the equilibrium provision of FDI incentives. However, I posit that presidential regimes have lower levels of legislative cohesion, which in turn affect levels of spending on FDI incentives. By setting the ax term as negative, I indicate that the low levels of legislative cohesion in presidential regimes negatively impacts the level of FDI incentives provided. I represent the executive's utility as follows:

$$u_E(x) = g(x) - x - ax \tag{3.6}$$

The executive's preferred level of x is found by maximizing u_E.

$$\max_x g(x) - x - ax$$

The first order condition for this maximization problem is given by

$$g'(x) - 1 - a = 0$$

In order to solve for x, I first isolate $g'(x)$

$$g'(x) = 1 + a$$

I then apply the inverse of g' to both sides of the equation

$$g'^{-1}(g'(x)) = g'^{-1}(1 + a)$$

Reducing the left hand side, I obtain

$$x_E = g'^{-1}(1 + a) \tag{3.7}$$

Order of play

In order for x to pass, the proposal needs the support of $n = \frac{N+1}{2}$ votes. Under a presidential regime, the agenda setter is the representative of the largest party in the legislature. This could be, for example, the speaker of the House of Representatives in the U.S. Congress. The legislative agenda setter makes a take-it or leave-it offer to the current legislative session, under a

"closed rule." No amendments can be made to the proposal. The legislature decides to accept or reject the proposal in this single period.

The bargaining game between the legislature and executive follows, with the legislature acting as agenda setter. Based on what it decides, the legislature then makes a take-it or leave-it offer to the executive x_2. After the executive decides to accept or reject the proposal, the game ends. I outline the game below.

1. The legislative agenda setter proposes x_1.
2. The legislature chooses to accept or reject x_1. If the legislature accepts, x_1 is to be sent to the executive. If the legislature rejects x_1, a status quo policy x_s is to be sent to the executive, where $x_s < x_L$. The policy sent to the executive is x_2.
3. The legislature proposes x_2 to the executive.
4. The executive chooses to accept or veto x_2. If the executive accepts, x_2 is implemented. If the executive vetoes x_2, a status quo proposal x_s is implemented, where $x_s < x_E < x_L$.
5. The game ends.

Equilibrium solution concept and equilibrium

Once again, the equilibrium solution concept is SPNE and I solve the game using backwards induction. The intuition is similar to a Romer and Rosenthal (1979) type model, which features some symmetric loss function

around an ideal point. The executive, as the veto player, will accept any proposal that is closer to her ideal point x_E than to the status quo x_s. The executive will accept any proposal x_i that is further to the right than x_s, up to the point where x_i is so far to the right that it makes her worse off than x_s. This can be represented as $x_E + (x_E - x_s) = 2x_E - x_s$. The idea is that as x_s converges on x_E, the range for which the executive accepts a proposal collapses to a single point.

Given the strict quasi-concavity of the executive's utility function and the assumption that $x_s < x_E$, we can define a value of $x \equiv \tilde{x_E} > x_s$ such that $u_E(x_s) = u_E(\tilde{x_E})$. Assume also that $u_E(x_s) > u_E(x_L)$. The executive's best response is therefore to accept any proposal $x_1 = \tilde{x_E}$ and to veto any other proposal. The legislature's strategy, then, is to propose $x_1 = \tilde{x_E}$. As result, the equilibrium is (where Pr stands for president):

$$x^*_{Pr} = \tilde{x_E}, \tag{3.8}$$

<u>Comparative statics</u>

To examine the effect of legislative cohesion, I again conduct a simple comparative statics exercise. Taking equation 3.7, I maximize with respect to a, the legislative cohesion parameter. Note that in light of the Inada conditions assumed earlier, g' is positive.

$$\max_a g'^{-1}(1+a)$$

By the chain rule, and because of the properties of $g(x)$ enumerate above, it follows that

$$-g''^{-2}(1) < 0$$

As assumed in the Inada conditions, g'' is negative. This reduces to

$$-g''^{-2} < 0 \tag{3.9}$$

As equation 3.9 demonstrates, the effect of low legislative cohesion on the equilibrium level of FDI spending in presidential regimes is negative.

3.3.3 Discussion

The comparative statics exercises for both the parliamentary and presidential models return two basic conclusions: high levels of legislative cohesion in parliamentary regimes have a positive effect on the equilibrium level of FDI spending, while low levels of legislative cohesion in presidential regimes have a negative effect. A simple comparison of equilibrium outcomes from the two models demonstrates that preferred levels of spending on FDI incentives in presidential systems x^*_{Pr} is lower than spending in parliamentary systems x^*_P. As $u_E(x_s) > u_E(x_L)$, this means that $x^*_P = x_L > x^*_{Pr} = \tilde{x_E}$.

Accordingly, I produce the following hypothesis:

H1: Democratic governments with higher levels of legislative cohesion provide higher levels of FDI incentives

3.4 FDI inflows and executive regimes

It is possible that opposition to FDI inflows gains strength as the level of FDI inflows increases. Following Rogowski (1989), it is likely that the domestic beneficiaries of increased FDI inflows will seek to maintain or accelerate FDI inflows, while those injured will endeavor to slow or stop inflows. As more foreign companies capture more of the domestic market share, domestic capital collective action through lobbying may be facilitated at higher levels of intensity, as smaller groups are more easily able to overcome the collective action problem (Olson 1965). More intense lobbying by domestic capital may weaken politician support for FDI incentives in both presidential and parliamentary systems. In order to explore these claims, I run two additional comparative statics exercises on actor utilities from the parliamentary and presidential models above. As the legislative bargaining framework in each model remains the same, I do not repeat it below. To represent FDI inflows, I introduce the additional parameter b .

3.4.1 Parliamentary regime

All legislators are assumed to have complete information. Spending on x provides each legislator with benefits according to the function $g(x)$. As above, assume also that $g(x)$ satisfies the usual Inada conditions. Legislators have quasi-linear utility, implying that each legislator has strictly quasi-concave utility in x and a unique ideal point exists for each legislator where

marginal benefits equal marginal costs.

In order to pay for x, legislators use tax revenue. Assume that taxation of their constituents imposes a constant marginal cost of unity on each legislator. This means that each legislator pays the same, constant amount for extracting this tax revenue. Each legislator represents an equal-sized constituency, such that her constituents only need to pay $\frac{x}{N}$ of the cost. Levels of legislative cohesion impact the level of spending on FDI incentives, which I represent as a. I now introduce a new parameter b, which represents the level of FDI inflows. The multiplicative term bx denotes the combined effect of FDI inflows on FDI incentives spending. I assume that $b > 0$. The inclusion of the bx term in each actor's utility function ensures that the consequences of FDI inflows on FDI incentives spending play a role in the following bargaining games. I define the utility of each legislator $i \in 1, 2, ..., N$ as

$$u_i(x) = g(x) + ax - (\frac{x}{N} + bx) \tag{3.10}$$

What is each legislator's preferred level of x ? I proceed by maximizing u_i.

$$\max_x g(x) + ax - (\frac{x}{N} + bx)$$

The first order condition for this maximization problem is given by

$$g'(x) + a - (\frac{1}{N} + b) = 0$$

In order to solve for x, I first isolate $g'(x)$

$$g'(x) = \frac{1}{N} + b - a$$

I then apply the inverse of g' to both sides of the equation

$$g'^{-1}(g'(x)) = g'^{-1}(\frac{1}{N} + b - a)$$

Reducing the left hand side, I obtain

$$x_i = x_{L2} = g'^{-1}(\frac{1}{N} + b - a) \tag{3.11}$$

Comparative statics

In order to determine the effect of FDI inflows on the equilibrium level of FDI incentives provided, I conduct a simple comparative statics exercise by maximizing x_{L2} with respect to b. Note that in light of the Inada conditions assumed earlier, g' is positive.

$$\max_b g'^{-1}(\frac{1}{N} + b - a)$$

By the chain rule, and because of the properties of $g(x)$ enumerated above, it follows that

$$-g''^{-2}(1) < 0$$

As assumed in the Inada conditions, g'' is negative. This reduces to

$$-g''^{-2} < 0 \tag{3.12}$$

As equation 3.12 demonstrates, the effect of increasing levels of FDI inflows on the equilibrium level of FDI spending in a parliamentary regime is negative.

3.4.2 Presidential regime

In the presidential regime model, I focus only on the executive's utility, as this determines the equilibrium level of FDI spending. As before, assume that the Inada conditions hold and that the executive has quasi-linear utility, meaning that her utility is strictly quasi-concave in x and that a unique ideal point exists for her. The executive holds the power of veto and represents the entire country. The legislative cohesion and FDI incentives effect is represented as before by ax. As with the parliamentary model in this section, the bx term represents multiplicative effect of FDI inflows. I denote the executive's utility as follows:

$$u_E(x) = g(x) - (x + ax + bx) \tag{3.13}$$

The executive's preferred level of x is found by maximizing u_E.

$$\max_x g(x) - (x + ax + bx)$$

The first order condition for this maximization problem is given by

$$g'(x) - 1 - a - b = 0$$

In order to solve for x, I first isolate $g'(x)$

$$g'(x) = a + b + 1$$

I then apply the inverse of g' to both sides of the equation

$$g'^{-1}(g'(x)) = g'^{-1}(a + b + 1)$$

Reducing the left hand side, I obtain

$$x_{E2} = g'^{-1}(a + b + 1)$$

Comparative statics

In order to determine the effect of FDI inflows on the equilibrium level of FDI incentives provided, I conduct a simple comparative statics exercise by maximizing x_{E2} with respect to b. Note that in light of the Inada conditions assumed earlier, g' is positive.

$$\max_b g'^{-1}(a + b + 1)$$

By the chain rule, and because of the properties of $g(x)$ enumerated above,

it follows that

$$-g''^{-2}(1) < 0$$

As assumed in the Inada conditions, g'' is negative. This reduces to

$$-g''^{-2} < 0 \tag{3.14}$$

As equation 3.14 demonstrates, the effect of increasing levels of FDI inflows on the equilibrium level of FDI incentives in a presidential regime is negative. The above exercises can be taken together to return the following hypothesis:

H2: The interaction between legislative cohesion and FDI inflows has a negative effect on levels of FDI incentives provided in democracies

3.5 Conclusion

In this chapter, I have presented a formal derivation of my theory of the politics of FDI incentives provision. Using a version of the Baron-Ferejohn legislative bargaining model, I examine how legislative cohesion affects politician preferences for FDI incentives and how bargaining under different executive regimes produces different equilibrium levels of FDI incentives. I then explore the interaction effect between increasing levels of FDI inflows and legislative cohesion on equilibrium levels of FDI incentives. As a re-

sult, I derive two testable hypotheses. The first hypothesis suggests that democratic governments with higher levels of legislative cohesion provide more generous FDI incentives. This implies that parliamentary democracies, which feature greater legislative cohesion, will be expected to provide higher levels of FDI incentives. The second hypothesis posits that the interaction between legislative cohesion and FDI inflows has a negative effect on FDI incentives provided. In Chapter 4, I empirically examine both hypotheses using a unique cross-national dataset. Chapters 5 and 6 explore the mechanisms of the first hypothesis in two qualitative case studies from the set of post-socialist countries.

Chapter 4

Legislative cohesion and FDI incentives: results from cross-national empirical analysis

4.1 Introduction

In this chapter, I test the two hypotheses described in Chapter 2 and formally derived in Chapter 3. According to my theory of the politics of FDI incentives provision, FDI inflows have distributional consequences that shape the preferences of domestic groups with respect to FDI incentives. As moderated by executive regime type, democratic governments implement

FDI incentives policies based on domestic preferences. FDI inflows compete up wages for labor and push down the rents received by domestic capital. As a result, labor prefers incentives to attract FDI, while domestic capital opposes FDI incentives. Parliamentary regimes, which feature greater legislative cohesion are expected to provide higher levels of FDI incentives. By contrast, presidential regimes are characterized by lower legislative cohesion are expected to provide lower levels of FDI incentives. As noted previously, Hypothesis 1 suggests a positive relationship between legislative cohesion and levels of FDI incentives offered. Hypothesis 2 focuses on the interaction effect between legislative cohesion and FDI incentives. Higher FDI inflows do not necessarily result in greater support for FDI incentives, in part due to the fact that greater threats to host firms may intensify opposition to FDI incentives provided. This greater opposition to FDI incentives may weaken the effect of legislative cohesion. Hypothesis 2, then, predicts a negative relationship between the interaction of legislative cohesion and FDI inflows with FDI incentives provided.

To test these hypotheses, I use webscraping and automated content analysis techniques to build an original dataset of FDI incentives based on U.S. government documents. I combine my FDI incentives dataset with data from the Quality of Government database (Teorell et al. 2013). After running a pooled ordinal probit model, I then examine whether the unbalanced panel structure of my dataset requires a alternate analytical model specification by conducting likelihood ratio tests for temporal and regional-level depen-

dencies. Based on results from the likelihood ratio tests, I then run a fixed effects ordinal probit model with allowances for temporal and regional-level dependencies.

The rest of the chapter is as follows. The next section describes the data, including dependent, independent, and control variables. In line with my focus on post-socialist countries, I then provide descriptive statistics comparing post-socialist countries to the rest of the world. Next, I present the pooled ordinal probit model and results, providing interpretation with the assistance of changes in predicted probabilities visuals. I then present the ordinal probit model adjusted for the unbalanced panel data structure, describe results, and present changes in predicted probabilities visuals. A conclusion sums up.

4.2 Data

4.2.1 Dependent variable

Scholars studying FDI incentives are faced with the problem of a paucity of data. To date, empirical work on FDI incentives in political science has been largely limited to Li (2006). In Li (2006), the author builds a cross-national database of tax incentives for FDI, including value-added tax, corporate income tax, property tax, licensing fees, import duties, and sales tax incentives. The author uses 53 documents covering individual countries from 2001, called "Country Commercial Guides," from the U.S. Commercial

Service, a bureau within the U.S. Department of Commerce. Using manual coding techniques, the author assigns a value of 1 or 0, depending on whether the country offered a particular incentive. The level of tax incentives in a country is then derived by adding up the values on the six types of incentives, ranging from 0 to 6. A higher score corresponds to a higher level of FDI incentives.

While Li (2006) makes an important step towards a better understanding of the politics of FDI incentives, the dataset used is limited for at least two reasons. First, the number of observations in Li (2006) is rather small, at 53. This raises questions about the representativeness of the sample used. The small sample size is also low for most MLE type models, such as the ordinal probit models Li uses. As King and Zeng (2001) point out, the statistical literature suggests that logit coefficients are biased in small samples (under about 200). Second, the "Country Commercial Guides" contain additional information on FDI incentives beyond tax incentives that would ostensibly be relevant to the analysis of the politics of FDI incentives, such as whether or not a country has specialized agencies dedicated to promoting FDI or assisting foreign companies in navigating bureaucracy.

With these critiques in mind, I build on Li (2006) to develop a larger dataset and an expanded measure of FDI incentives. In 2003, the U.S. Commercial Service began calling the documents that contain investment information on different countries around the world "Investment Climate Statements." In order to efficiently collect and classify these documents on

a larger scale, I used the R software program to collect 1400 "Investment Climate Statements" from 2005-2014. Each of the documents corresponds to an individual country-year. I then conducted automated content analysis to classify the documents in line with Li (2006). After using webscraping techniques to collect and preprocess documents (Feinerer et al. 2008), I hand coded 140 documents as per Li's approach, while adding an additional variable to represent whether a country had an "investment promotion agency." 135 countries are covered in the dataset. Wells and Wint (2002) note that investment promotion entails the provision of information to potential investors, creating an attractive image of the country as a place to invest, and providing services to prospective and current investors. Investment promotion agencies (IPAs) typically provide these services (Cass 2007). I argue that the existence of an IPA in a country is an important indicator of provision of FDI incentives and thus include it as a seventh binary variable in my index of FDI incentives, which ranges from 0-7.

After manual coding was completed, I used the R software to run a series of four training algorithms, which classified uncoded documents as per the manually coded documents (Stewart and Zhukov 2009; Jurka et al. 2011). When running the training algorithms, however, I noticed that two algorithms, support vector machines (SVM) (Pouteau et al. 2012) and random forests (Forests) (Breiman 2001), coded the country documents as either having many more incentives or many fewer incentives than the other two algorithms, Logitboost (Friedman et al. 1998) and general linearized models

(GLM) (Jurka 2012). The ultimate result was that the number of incentives coded was significantly lower than expected, given Li's (2006) data.[1] As such, I re-ran the training algorithms with only Logitboost and GLM, which provided more consistent results. It should be noted that the typical approach to analyzing results using machine learning techniques assumes a larger sample size than used here, although a number of studies employ these techniques on sample sizes comparable to the one used here (e.g., Hopkins and King 2010). Instead of presenting typical precision and accuracy diagnostics, I report data on agreement across the two training algorithms. If both algorithms agree across all observations, agreement would be equal to 1. As compared to algorithm agreement across the original four algorithms, agreement between logitboost and GLM is much higher across the board with no variables having agreement less than 0.72. I also report data on the proportion of documents that were machined-coded 1.

Table 4.1: Machine Learning Algorithm Diagnostics

Variable	**Agreement**	**Proportion Coded 1**
Value-added tax	0.815	0.172
Corporate tax	0.72	0.131
Property tax	0.913	0.113
Licensing fees	0.928	0.111
Import duty	0.801	0.178
Sales tax	0.928	0.114
Investment promotion agency	0.767	0.163

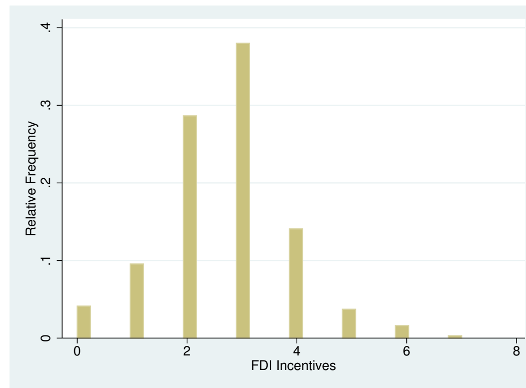
[1] I thank Quan Li for providing replication data.

In order to check coding reliability, I provide a comparison of manually coded and machine coded observations for each of the seven variables as well as the total incentives coded for each observation.

Table 4.2: Reliability Checks

Variable	**Correlation**
Value-added tax	0.753
Corporate tax	0.696
Property tax	0.845
Licensing fees	0.929
Import duty	0.746
Sales tax	0.721
Investment promotion agency	0.748
Total incentives	0.784

Figure 4.1: Univariate Distribution of *FDI Incentives*



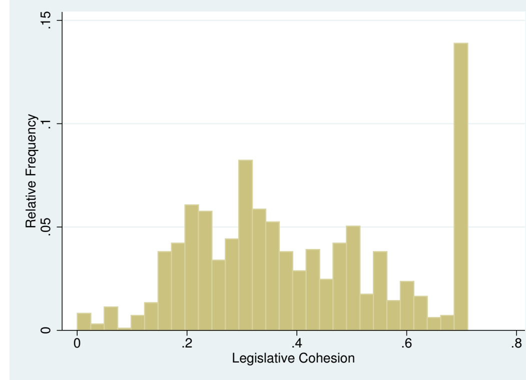
4.2.2 Independent variables

In order to test Hypothesis 1, I employ the Political Constraints Index III (Henisz 2000) from the 2013 Quality of Government Dataset. The index measures the feasibility of policy change, defined as the extent to which a change in the preferences of a political actor would lead to a change in government policy. The index ranges, theoretically, from 0 to 1 and includes the following: the number of independent branches of government with veto power over policy change, counting the executive and the presence of an effective lower and upper house in the legislature (more branches leading to more constraints); the extent of party alignment across branches of government, measured as the extent to which the same party or coalition of parties controls each branch (decreasing the level of constraint); and the extent of preference heterogeneity within each legislative branch, measured as legislative fractionalization in the relevant house (increasing constraints for aligned executives and decreasing constraints for opposed executives).

As it is constructed, higher Political Constraints Index III scores correspond to lower feasibility of policy change and thus lower legislative cohesion. However, my main argument suggests that greater legislative cohesion leads to higher levels of FDI incentives provision. In order to make the results more intuitive, I invert the Political Constraints Index III scale so that higher scores correspond to higher legislative cohesion. This variable is called *Legislative Cohesion*. Consistent with Hypothesis 1, I expect a positive relationship between *Legislative Cohesion* and *FDI Incentives*. Figure 4.2 depicts the

univariate distribution of the *Legislative Cohesion* variable.

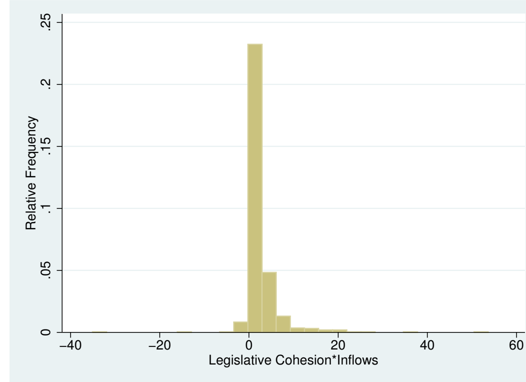
Figure 4.2: Univariate Distribution of *Legislative Cohesion*



In order to test Hypothesis 2, I create an interaction term for the relationship between legislative cohesion and FDI inflows, *Legislative Cohesion*Inflows*. By definition, FDI constitutes net inflows of investment that acquire a sustained management interest (10% or more of voting stock) in an enterprise operating in an country other than that of the investor. FDI consists of the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital. The variable, drawn from the World Bank, is measured by net inflows divided by GDP. The range for the FDI inflows variable is from -161.240 to 172.716. Negative values for the FDI inflows variable indicate that a capital outflow has taken place. I construct the interaction term by multiplying the FDI inflows variable by the inverse Political Constraints Index III variable. The interaction term ranges from -35.093 to 53.638. Consistent with Hypothesis 2, I predict that the effect of legislative cohesion on FDI incentives, conditioned on the level of FDI in-

flows, will be negative. Figure 4.3 depicts the univariate distribution of the *Legislative Cohesion*Inflows* variable.

Figure 4.3: Univariate Distribution of *Legislative Cohesion*Inflows*



4.2.3 Controls

All control variables are drawn from the Quality of Government database. I account for five potentially confounding factors. These include FDI inflows, level of democracy, economic development, size of economy, and interstate competition. By controlling for FDI inflows, I account for significant differences across countries with regard to the volume of FDI inflows, which may affect provision of FDI incentives. Countries that receive a high volume of FDI inflows and are more open may be more likely to respond to FDI incentives competition (Mutti 2003). This suggests that FDI incentives are higher in these countries. I expect that the level of FDI inflows is positively associated with the level of FDI incentives. As above, the FDI inflows control variable, represented below as *Inflows*, is based on data from the World

Bank.

Within the universe of democracies, there is significant variation in property rights protection (Kaufmann et al. 2004, Sunde et al. 2007). In democracies where property rights protection is weaker, governments may offer FDI incentives to improve locational attractiveness. Additionally, policy predictability is higher in democracies (Jensen 2003; Li and Resnick 2003; Pinto 2013). I expect, then, that at higher levels of democracy, tax incentives are lower and vice versa. I use Polity 2 scores to control for level of democracy (Marshall, Gurr, and Jaggers 2013). The Polity 2 scores present a spectrum of governing authority ranging from fully institutionalized autocracies to mixed, or incoherent, authoritarian regimes to fully institutionalized democracies (Jaggers and Gurr 1995). The Polity 2 score used here is a modified version of the Polity variables to facilitate use in time-series analyses. It alters the combined annual Polity score by converting "special" instances of Polity scores to conventional Polity scores, which range from -10 to 10 (Marshall, Gurr, and Jaggers 2013). Regimes with a score of -6 to -10 are considered autocracies. As I am analyzing variation in FDI incentives provided in democracies, I subset out autocracies from the analysis. This variable is called *Democracy*.

The size of a country's economy may affect the level of tax incentives in a number of ways (Guisinger 1985). Large countries usually have large markets, as compared to smaller countries, which means that the larger countries may have greater bargaining power with respect to foreign investors. In addi-

tion, larger countries may have numerous levels of government, which would make coordination on FDI incentives, as well as other policies, challenging. Smaller countries, by contrast, may have smaller and more centralized governments, making policy coordination easier. As such, I expect that the size of a country's economy is negatively related to the level of FDI incentives. Following a number of studies such as Resnick (2001) and Li and Resnick (2003), I use log purchasing power parity GDP from the World Bank for size of economy and call this variable *Size*.

A country's level of economic development may also affect provision of FDI incentives. As FDI incentives entail budgetary consequences, it can be postulated that highly developed countries are able to offer FDI incentives more readily than less developed countries. On the other hand, FDI incentives may send a signal to investors that a country needs to offset certain locational disadvantages by offering generous incentives to foreign investors. To control for level of economic development, I use log purchasing power parity GDP per capita from the World Bank and represent this variable as *Development*.

The final two control variables are *External Pressure* and *External Pressure Squared*. Tax competition may occur within a region because of shared political and cultural characteristics as well as resource endowments (Guisinger 1985). Because tax incentives entail budgetary consequences, governments are unable to offer unlimited incentives. The point is that tax incentives are likely to decline once above a certain threshold. Following Li (2006),

I compute an average level of incentives index for all countries in a region to represent the nonlinear effect of international tax competition.[2] The effect of external pressure should be positive, while external pressure squared should have a negative effect on the level of FDI incentives. Descriptive statistics for all variables are provided in an appendix to the chapter.

4.3 Post-socialist cases

Before proceeding to the cross-national analysis, I briefly compare the post-socialist cases to other countries. As noted above, the post-socialist cases offer a unique environment in which to consider theories developed in other parts of the world. The singular nature of simultaneous political and economic development that post-socialist countries have undergone since 1989 implies that the post-socialist context acts as a quasi-experimental setting in which to analyze policy choice.

In this section, I provide descriptive statistics comparing the set of post-socialist countries[3] to the rest of the world. The first set of graphs shows the univariate distribution of the FDI incentives variable between the two sets

[2]The regions are as follows: Eastern Europe and post Soviet Union (including Central Asia); Latin America (including Cuba, Haiti and the Dominican Republic); North Africa and the Middle East (including Israel, Turkey and Cyprus); Sub-Saharan Africa; Western Europe and North America (including Australia and New Zealand); East Asia (including Japan and Mongolia); South-East Asia; South Asia; the Pacific; and the Caribbean.

[3]The post-socialist countries include Albania, Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Russia, Romania, Slovakia, Slovenia, Tajikistan, and Ukraine.

of countries. As is evident, both sets of countries follow a roughly similar right-skewed distribution.

Figure 4.4: Univariate Distribution of *FDI Incentives*, Post-Socialist Countries

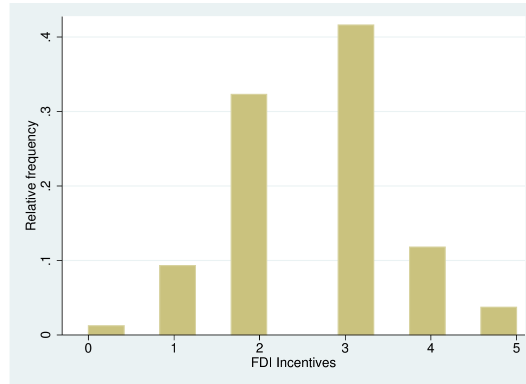
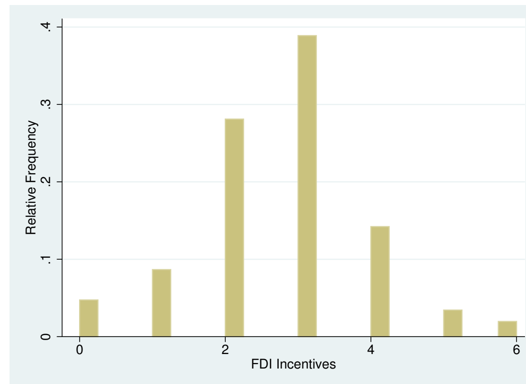


Figure 4.5: Univariate Distribution of *FDI Incentives*, World



The next set of graphs depict scatterplots for both sets of countries. While the post-socialist scatter plot shows a modest increase in the density of FDI incentives when moving from 2 to 3 incentives provided, the world scatter plot is less clear.

Figure 4.6: Univariate FDI Incentives and Legislative Cohesion, Post-Socialist Countries

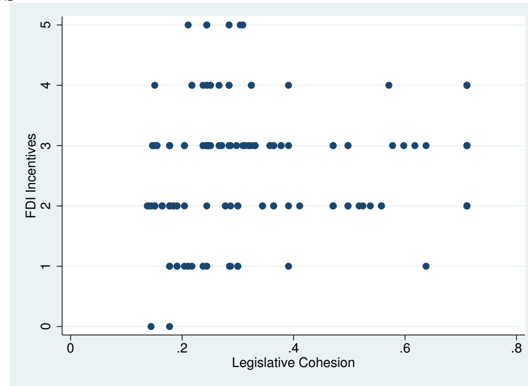


Figure 4.7: FDI Incentives and Legislative Cohesion, World

Table 4.3 provides descriptive statistics comparing the post-socialist and world country sets. While the mean level of FDI incentives is nearly identical across both sets of countries, the standard deviation for the post-socialist countries is smaller. However, an F-test demonstrates that the difference between these two standard deviations is not statistically significant.

Table 4.3: Descriptive Statistics for FDI Incentives, Post-Socialist Countries vs. World

Subset	Mean	Std. Dev.	Min	Max
Post-socialist countries	2.646	0.977	0	5
World	2.673	1.18	0	6

Further exploratory analysis is undoubtedly required to compare and contrast the post-socialist countries with other countries around the world.

4.4 Pooled ordinal analysis

4.4.1 Empirical strategy

The analysis begins with a simple pooled model. While the cross-national level of FDI incentives is likely continuous, this continuum is latent and unobservable. The FDI incentives variable I have constructed, however, is observable and consists of eight ordered categories, ranging from 0 to 7. The latent model is specified below:

$$y_i^* = \beta_0 + \beta_1 \, LegislativeCohesion_i + \beta_2 \, LegislativeCohesion_i * Inflows_i + \beta_3 \, Inflows_i + \beta_k \, Control_i + \epsilon_i \quad (4.1)$$

where y^* is the continuous latent variable, the βs are unknown parameters for independent variables and various control variables, while ϵ_i is the error term. First, β_1 measures the effect of legislative cohesion on the level of FDI incentives. I expect that this is positive, based on Hypothesis 1. β_2 is the effect of legislative cohesion on the level of FDI incentives, conditioned on the level of FDI inflows. As noted in Hypothesis 2, I expect this to be negative.

Instead of y_i^*, I observe the FDI incentives variable y_i, which is rank ordered and limited in terms of the number of categories. I therefore use ordered probit to estimate the effects of the explanatory variables, *Legislative Cohesion* and *Legislative Cohesion*Inflows*, on the continuum of FDI incentives offered by different countries. Because hypotheses are directional, I use a one-tailed test.

4.4.2 Results

In Tables 4.4 and 4.5, I present the results of cross-national empirical analysis. Table 4.4 does not include the interaction term, while Table 4.5 does. In Table 4.4, Model 1 is the most basic and includes only *Legislative Cohesion* and *Democracy.* Model 2 adds *Inflows*, while Model 3 includes controls for economic development and size of economy. Model 4 adds the external pressure and external pressure squared variables. Table 4.5 follows a similar pattern, where Model 1 includes only *Legislative Cohesion* and *Democracy.* Model 5 adds the interaction term and the FDI inflows variable. Model 6 includes controls for economic development and size of economy,

while Model 7 adds the external pressure and external pressure squared variables.

Table 4.4: The Effect of Executive Regime Type on FDI Incentives

Variable	**Model 1**	**Model 2**	**Model 3**	**Model 4**
Legislative Cohesion	0.484*	0.54**	0.314	0.237
	(0.261)	(0.265)	(0.268)	(0.269)
Inflows	-	0.0001	-0.0001	0.001
		(0.005)	(0.006)	(0.006)
Democracy	-0.018*	-0.018*	0.008	0.005
	(0.01)	(0.01)	(0.011)	(0.011)
Size	-	-	-0.008	-0.009
			(0.029)	(0.029)
Development	-	-	-0.256***	-0.254***
			(0.044)	(0.044)
External Pressure	-	-	-	1.628
				(1.25)
External Pressure Squared	-	-	-	-0.271
				(3.09)
N	740	726	716	716
AIC	2253.823	2220.031	2135.077	2128.081

(Standard errors in parentheses)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

Table 4.4 demonstrates mixed results for my main hypothesis. Models 1 and 2 indicate that the effect of *Legislative Cohesion* on the level of FDI incentives provided is statistically significant and positive. However, Models 3 and 4 show that this relationship is positive, but not statistically significant. Lower AIC scores indicate better model fit, so based on the AIC

scores provided for Models 1 and 2, Model 2 is the best fit among models returning positive and significant results for *Legislative Cohesion* without the interaction term.

Table 4.5: The Effect of Executive Regime Type on FDI Incentives with Interaction Term

Variable	**Model 1**	**Model 5**	**Model 6**	**Model 7**
Legislative Cohesion	0.484*	0.988***	0.783**	0.711**
	(0.261)	(0.309)	(0.312)	(0.312)
Legislative Cohesion*Inflows	-	-0.074***	-0.078***	-0.078***
		(0.013)	(0.026)	(0.026)
Inflows	-	0.035**	0.034***	0.035***
		(0.017)	(0.013)	(0.013)
Democracy	-0.018*	-0.019*	0.006	0.004
	(0.01)	(0.01)	(0.01)	(0.011)
Size	-	-	-0.008	-0.008
			(0.029)	(0.029)
Development	-	-	-0.257***	-0.255***
			(0.044)	(0.044)
External Pressure	-	-	-	1.739
				(1.251)
External Pressure Squared	-	-	-	-0.545
				(3.093)
N	740	726	716	716
AIC	2253.823	2214.031	2128.361	2121.226

(Standard errors in parentheses)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

Models 5, 6, and 7 depicted in Table 4.5 include the interaction term. In these models, the coefficients for non-interacted terms represent the con-

ditional effect of each non-interaction term on the dependent variable, conditional on the value of the interacted variable being zero. This means that values for the non-interacted terms correspond to those cases in which the level of FDI inflows equals zero. Model 1 is repeated from Table 2 in order to demonstrate that *Legislative Cohesion* is positive and significant across all four models, as expected. Taken together with results from Table 4.4, I find partial support for Hypothesis 1, that governments with higher levels of legislative cohesion are associated with higher levels of FDI incentives provided.

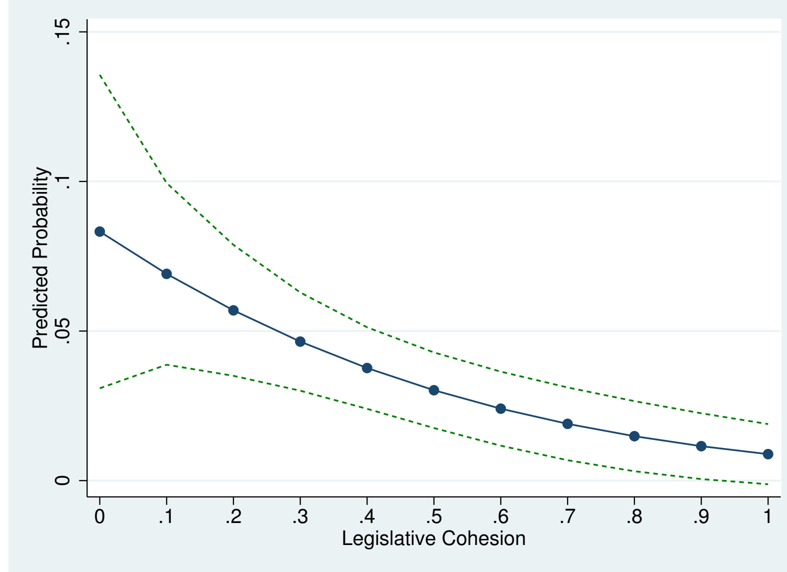
The coefficient for the interaction term is negative and significant across Models 5, 6, and 7. These results support Hypothesis 2 that, as moderated by the level of FDI inflows, the effect of legislative cohesion on FDI incentives provided is negative. AIC scores, which provide an assessment of relative model fit, suggest that all four models fit the data similarly. Lower AIC scores indicate better model fit, so by this metric Model 6 fits the data best.

Tables 4.4 and 4.5 show partial support for the posited negative effect of democracy on the level of FDI incentives provided, as suggested by Li and Resnick (2003) and Li (2006). The basic idea here is that more democratic countries need not offer as high levels of FDI incentives in order to be as attractive to foreign investors as less democratic countries. The effect of FDI inflows on the level of FDI incentives, which can be interpreted as those instances when legislative cohesion equals 0, has mixed support across Tables 4.4 and 4.5. While Table 4.4 does not provide support for the expected

positive relationship between these variables, Table 4.5 does. The results in Table 4.5 could be interpreted as meaning that FDI inflows reinforce efforts to provide more FDI incentives. The control for size of economy was not significant in the any of the models in which it was employed, while the control for level of development was negative and significant across all models in which it was used. The fact that the level of development was found to be significant suggests that more advanced economies do not need to offer high levels of FDI incentives in order to attract FDI. Controls for the effect of FDI incentives competition were not significant across any models.

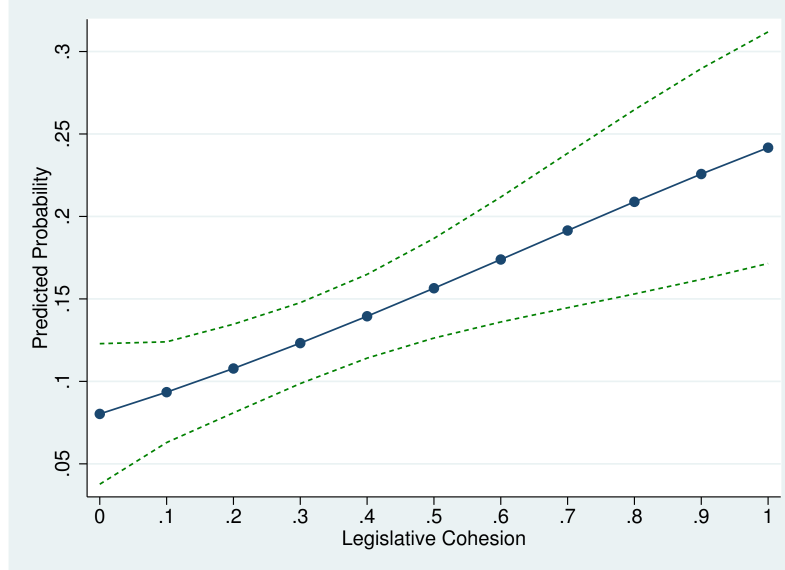
In order to present a more intuitive picture of the results from this first stage of analysis, I provide visuals depicting changes in predicted probabilities for the main hypothesis tested, at both low and high levels of FDI incentives. Model 2 serves as the basis for the visuals below. Low levels of FDI incentives correspond to when the FDI incentive index equals 0, while high levels of FDI incentives correspond to when the FDI incentive index equals 4. I choose 4 as the high level of FDI incentives because the number of observations for this category was significantly higher than the number of observations for categories 5, 6, and 7 combined. Each visual includes 95% confidence intervals.

Figure 4.8: Change in Predicted Probabilities, FDI Incentives=0



Holding the other variables to their means or medians, Figure 4.8 shows changes in predicted probabilities for the effect of *Legislative Cohesion* when the level of FDI incentives equals 0. The probability of the level of FDI incentives being 0 decreases from 0.081 to 0.019 as *Legislative Cohesion* increases. The narrow confidence intervals, after legislative cohesion approaches 0.3, suggest a decreasing level of uncertainty about this effect. The larger confidence intervals at lower levels of *Legislative Cohesion* are likely due to the relatively few observations on the left hand side of the *Legislative Cohesion* spectrum.

Figure 4.9: Change in Predicted Probabilities, FDI Incentives=4



Holding other variables to their means or medians, Figure 4.9 shows changes in predicted probabilities for the effect of *Legislative Cohesion* when the level of FDI incentives equals 4. The probability that the level of FDI incentives equals 4 increases from 0.089 to 0.243 as *Legislative Cohesion* increases. This provides support for Hypothesis 1. The confidence intervals narrow as *Legislative Cohesion* approaches 0.1, but grow wider after *Legislative Cohesion* reaches 0.5. This suggests that uncertainty about the effect increases after *Legislative Cohesion* reaches 0.5.

4.4.3 Model robustness

I ran robustness checks to reaffirm the above results. I conducted tests using an alternative measure of differences between parliamentary and pres-

idential regimes as well as a different measure of democracy. In order to check the robustness of the legislative cohesion variable, I used the variable *dpichecks* (Beck et al. 2001) from the Quality of Government database. This variable is a measure of the number of veto players in a country, ranging from 0 to 17. I inverted the variable so that higher scores reflect higher levels of legislative cohesion, as with the original Political Constraints independent variable. Results were largely significant and robust for Hypotheses 1 and 2. Next, I replaced the Polity 2 scores with combined Freedom House/Polity 2 scores. Here the scale ranges from 0 to 10, where 0 is the least democratic and 10 the most democratic. Both Freedom House and Polity scores are transformed to 0-10 scales and averaged. I subsetted out autocracies, defined as having a Freedom House/Polity2 score of less than 2. Results were largely significant and robust for both Hypotheses 1 and 2.

4.5 Panel data analysis

4.5.1 Potential issues

The dataset constructed for this chapter can be described as an unbalanced country-year panel. This means that each country does not have an observation for each year accounted for in the data. As such, there are two issues that the pooled ordinal model specification detailed above does not address. First, the basic ordinal model does not account for country-level heterogeneity. In other words, there may be omitted variables that impact

why countries differ with regard to levels of FDI incentives. As my theory assumes that differences between countries do have an impact on the level of FDI incentives offered, it would appear important to account for this heterogeneity. Second, the pooled ordinal model does not address the effect of time on levels of FDI incentives offered. In this section, I address these issues by specifying a model that better takes into account the structure of my data. I find the best approach to be one that employs an ordinal probit model with region-level and time fixed effects.

4.5.2 Model fit comparison

In order to determine whether or not the above issues need to be addressed, I conduct likelihood ratio tests to compare restricted and unrestricted models, as per Beck et al. (1998). The restricted model is the specification that omits the dummy variables accounting for temporal and region-level dependencies. There are three unrestricted models that include temporal, region-level, as well as temporal and region-level dummy variables.

I use region-level dummies instead of country-level dummies for the following reasons. Initial analysis using country-level dummies resulted in exclusion of 23 of 177 countries,[4] due to lack of variation on the dependent variable for these countries over the years observed. Region level effects do

[4]Omitted countries included: Bahamas, Barbados, Dominica, Grenada, St. Lucia, St. Vincent and the Grenadines, Antigua and Barbuda, St. Kitts and Nevis, Belize, Luxembourg, Monaco, Andorra, Malta, Bosnia and Herzegovina, Azerbaijan, Iceland, Sao Tome and Principe, Afghanistan, Maldives, Laos, Timor-Leste, and Micronesia

not lead to this problem. According to studies by Bjornskov et al. (2010) and Fischer (2010), the use of region fixed effects, defined by geographic proximity or ethnic distance (language), takes into account regional heterogeneity, while assuming country-specific effects to be random. Assuming that regional dummies sufficiently pick up unobservable between country heterogeneity, country-specific effects would be captured by the error term $\epsilon_{i,t}$. In order to estimate region fixed effects, I employ regional dummy variables that treat Eastern Europe and post-Soviet Union as the omitted category.[5]

Table 4.4 presents results from the likelihood ratio tests.

Table 4.6: Likelihood Ratio Test Results

Unrestricted model	χ^2	**Degrees of Freedom**	$p < 0.01$
Temporal Dummy	38.24	6	Yes
Region dummy	71.06	9	Yes
Temporal and region dummies	115.30	15	Yes

A likelihood ratio test comparing the restricted and temporal dummy unrestricted models yielded a χ^2 statistic of 38.24 with 6 degrees of freedom. A likelihood ratio test comparing the restricted and regional dummy unrestricted models yielded a χ^2 statistic of 71.06 with 9 degrees of freedom. Finally, a likelihood ratio test comparing the restricted and fully unrestricted model (temporal and regional dummies) yielded a χ^2 of 115.30, with 15 de-

[5]The regions are as follows: Eastern Europe and post Soviet Union (including Central Asia); Latin America (including Cuba, Haiti and the Dominican Republic); North Africa and the Middle East (including Israel, Turkey and Cyprus); Sub-Saharan Africa; Western Europe and North America (including Australia and New Zealand); East Asia (including Japan and Mongolia); South-East Asia; South Asia; the Pacific; and the Caribbean

grees of freedom. The probability of obtaining these results by chance is zero. These results suggest that the null hypothesis of the restricted and unrestricted models being equivalent should be rejected. As such, I conduct the analysis below using ordinal probit models with region-level and time fixed effects.

4.5.3 Empirical strategy

Similar to the pooled ordinal probit analysis, I assume a latent and unobservable continuum of cross-national FDI incentives offered. The FDI incentives variable I have constructed is observable, however. The latent panel model is specified below:

$$y^*_{i,t} = \mathbf{x_{i,t}}\beta + f_i + j_t + \epsilon_{i,t} \tag{4.2}$$

where $y^*_{i,t}$ is the continuous latent variable, $\mathbf{x_{i,t}}$ is a vector of independent and control variables, βs are unknown parameters for the independent variables and various control variables, f_i represents regional dummy variables, j_t represents year dummy variables, while $\epsilon_{i,t}$ is the error term.

Instead of y^*_i, I observe the FDI incentives variable y_i, which is rank ordered and limited in terms of the number of categories. This implies an ordinal model specification, as in the previous analysis. However, the panel data structure requires modification of the pooled model specification. As noted by Hsiao (2014), Beck (2001), Winkelmann and Winkelmann (1998),

and others, fixed effects are appropriate if the intention is to make inferences about observed units. As the dataset used in this chapter has fixed country units and I do not propose making inferences about a unit grouping beyond countries, a fixed effects specification is appropriate in addressing this region-level heterogeneity. I note above why I use regional-level fixed effects, as opposed to country-level fixed effects. To account for temporal dependence, Beck et al. (1998) suggest using temporal dummies, which is the approach I take here. In accounting for temporal dependence, I create a series of dummy variables with 2005 as the omitted category. 2012 is omitted from the analysis due to collinearity.

4.5.4 Results

In Tables 4.7 and 4.8, I present the results of fixed effects ordinal probit analysis. Similar to the analysis conducted above, Table 4.7 shows results without the interaction term and Table 4.8 provides results with the interaction term. Model 8 includes only *Legislative Cohesion* and *Democracy.* Model 9 adds *Inflows*, while Model 10 includes controls for economic development and size of economy. Model 11 adds the external pressure and external pressure squared variables. Table 4.8 repeats Model 8 for comparison purposes, while Model 12 adds the interaction term and *Inflows.* Model 13 brings in the economic development and size of economy controls, while Model 14 adds the regional competition variables.

As Tables 4.7 and 4.8 demonstrate, I find a consistently positive, sig-

Table 4.7: The Effect of Executive Regime Type on FDI Incentives, Panel Models

Variable	Model 8	Model 9	Model 10	Model 11
Legislative Cohesion	0.476***	0.532*	0.5*	0.5*
	(0.28)	(0.285)	(0.288)	(0.288)
Inflows	-	0.003	0.001	0.001
		(0.005)	(0.006)	(0.006)
Democracy	0.035***	0.033***	0.038***	0.038***
	(0.01)	(0.012)	(0.012)	(0.012)
Size	-	-	-0.013	-0.012
			(0.034)	(0.034)
Development	-	-	-0.157***	-0.155***
			(0.059)	(0.059)
External Pressure	-	-	-	-0.248
				(1.533)
External Pressure Sq.	-	-	-	2.63
				(3.331)
N	740	726	716	716
AIC	2126.091	2091.544	2052.511	2054.923

(Standard errors in parentheses; Dummy variable coefficients excluded)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

Table 4.8: The Effect of Executive Regime Type on FDI Incentives, Panel Models with Interaction Term

Variable	**Model 8**	**Model 12**	**Model 13**	**Model 14**
Legislative Cohesion	0.476***	1.321***	1.271***	1.269***
	(0.28)	(0.331)	(0.333)	(0.333)
Leg. Coh.*Inflows	-	-0.128***	-0.125***	-0.102***
		(0.027)	(0.027)	(0.027)
Inflows	-	0.059***	0.056***	0.056***
		(0.013)	(0.013)	(0.013)
Democracy	0.035***	0.033***	0.038***	0.038***
	(0.01)	(0.01)	(0.012)	(0.021)
Size	-	-	-0.012	-0.01
			(0.034)	(0.034)
Development	-	-	-0.153***	-0.155***
			(0.059)	(0.059)
External Pressure	-	-	-	0.236
				(1.533)
External Pressure Sq.	-	-	-	2.38
				(3.337)
N	740	726	716	716
AIC	2126.091	2070.769	2033.194	2035.924

(Standard errors in parentheses; Dummy variable coefficients excluded)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

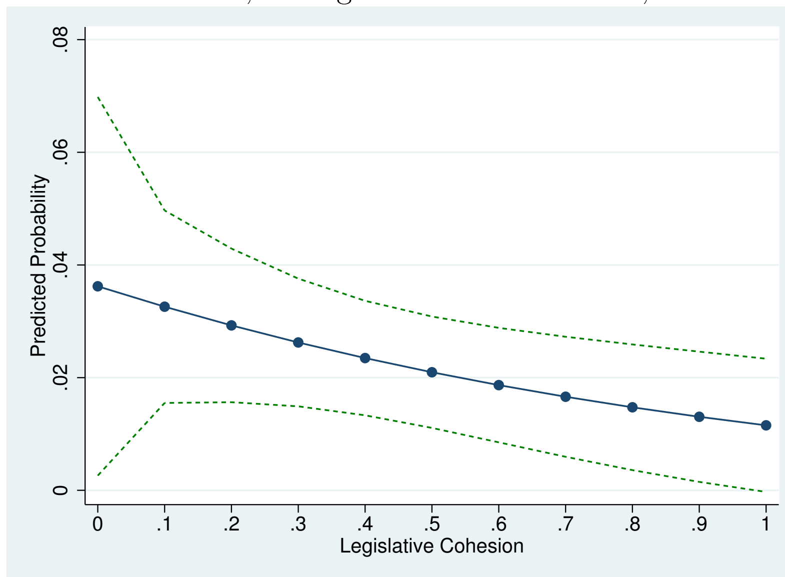
nificant relationship between *Legislative Cohesion* and *FDI Incentives* across all models. This suggests reasonably strong support for Hypothesis 1. Similar to the pooled ordinal analysis above, Models 12, 13, and 14 include the interaction term. As in the pooled ordinal analysis, the coefficient for the interaction term is negative and significant across Models 12, 13, and 14. These results support Hypothesis 2, which suggests that as moderated by the level of FDI inflows, the effect of legislative cohesion on FDI incentives provided is negative.

Tables 4.7 and 4.8 also depict a positive relationship between levels of democracy and FDI incentives, in contrast to the pooled models. The models in Table 4.8 support the idea that FDI inflows are positively associated with the level of FDI incentives provided. Table 4.8 shows support for the idea that FDI inflows are positively associated with FDI incentives offered, while Table 4.7 does not provide support. Tables 4.7 and 4.8 show that a country's level of economic development has a negative effect on the level of FDI incentives provided, which is consistent with the pooled ordinal models. As before, controls for size of economy and regional competition were not significant across all models. Finally, based on AIC scores, Models 10 and 13 best fit the data.

As above, I provide visuals depicting changes in predicted probabilities for Hypothesis 1, at both low and high levels of FDI incentives. Model 8 serves as the basis for the visuals shown below. Low levels of FDI incentives correspond to when the FDI incentive index equals 0, while high levels of FDI

incentives correspond to when the FDI incentive index equals 4. I choose 4 as the high level of FDI incentives because the number of observations for this category was significantly higher than the number of observations for categories 5, 6, and 7 combined. Each visual includes 95% confidence intervals.

Figure 4.10: Panel Data, Changes in Predicted Prob., FDI Incentives=0



Holding other variables to their means or medians, Figure 4.10 shows changes in predicted probabilities for the effect of *Legislative Cohesion* when the level of FDI incentives equals 0. The probability of the level of FDI incentives being 0 decreases from 0.031 to 0.013 as *Legislative Cohesion* increases. The wider confidence intervals are likely related to the small number of observations at low levels of *Legislative Cohesion*.

Figure 4.11: Panel Data, Changes in Predicted Prob., FDI Incentives=4

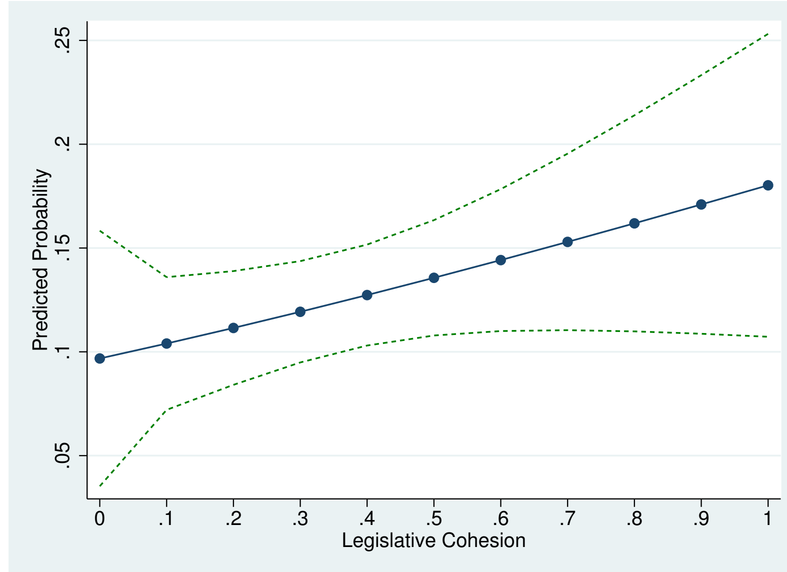


Figure 4.11 depicts changes in predicted probabilities for the effect of *Legislative Cohesion* when the level of FDI incentives equals 4, holding other variables to their means or medians. The probability of the level of FDI incentives being 4 increases from 0.098 to 0.181 as *Legislative Cohesion* increases. This supports Hypothesis 1. The wide confidence intervals at low levels of *Legislative Cohesion* are, again, likely related to the small number of observations at those particular levels of *Legislative Cohesion*. In addition, the confidence intervals become wider after *Legislative Cohesion* reaches 0.5, which suggests growing uncertainty about this effect at higher levels of *Legislative Cohesion*.

4.5.5 Model robustness

I ran the same robustness checks as for the pooled ordinal analysis to reaffirm the panel analysis results, using the inverted *dpi_checks* variable and the combined Freedom House/Polity 2 variable. Results were largely significant and robust for both Hypotheses 1 and 2.

4.6 Conclusion

The analysis in this chapter has explored the two hypotheses described and derived in Chapters 2 and 3. Hypothesis 1 suggests that legislative cohesion in democracies is positively associated with levels of FDI incentives. Hypothesis 2 posits a negative association between legislative cohesion, as moderated by FDI inflows, and the level of FDI incentives offered. In testing these hypotheses with an original dataset generated using machine learning techniques, I apply two model specifications. The first comprises a series of pooled ordinal probit models and the second includes ordinal probit models with region and time fixed effects.

Results from the pooled ordinal analysis provide mixed support for Hypothesis 1, while the panel models are strongly supportive. Both the pooled and panel models support Hypothesis 2. I find contradictory evidence regarding the contention that democracy has a negative effect on the level of FDI incentives provided (Li 2006; Li and Resnick 2003). The pooled models indicate a negative relationship between democracy and FDI incentives,

while the panel models suggest the opposite. There is also contradictory evidence regarding the relationship between FDI inflows and levels of FDI incentives offered. Some of the panel models indicate a negative relationship between these variables, while some of the pooled models suggest the opposite. Finally, the effect of level of development on FDI incentives provided is negative across all pooled and panel models, as expected.

While this chapter has established support for my main hypothesis, the large-N empirical analysis I conduct makes important assumptions about the causal mechanisms underpinning my theory of the politics of FDI incentives provision. In moving from causal effects to causal mechanisms, the analysis in Chapters 5 and 6 shifts the focus to case studies of Poland and Romania. These chapters consider the distributional consequences of FDI inflows and executive regime type dimensions from a qualitative perspective.

4.7 Appendix

Table 4.9: Descriptive Statistics

Variable	**Unit**	**Obs**	**Mean**	**Std. Dev.**	**Min**	**Max**
Legislative Cohesion	0-1	972	0.398	0.183	0	0.711
Democracy	Index	741	5.777	4.831	-6	10
Region	Dummy	984	4.173	2.488	1	10
Leg. Coh.*Inflows	Composite	796	2.260	4.154	-35.093	53.638
Inflows	% of GDP	804	5.683	11.882	-161.240	172.716
Size	Log of $US bn	792	24.819	1.980	19.151	29.028
Development	Log of $US bn	792	8.799	1.276	5.624	11.212
Ext. Pressure	Composite	984	0.129	0.089	0	.444
Ext. Pressure Sq.	Composite	984	0.025	0.036	0	0.197
Years	Dummy	995	2008.836	2.308	2005	2012

Sources: Teorell et al. 2013; Author calculations

Chapter 5

Parliamentarism and FDI incentives in Poland

5.1 Introduction

In previous chapters, I argue that the distributional consequences of FDI inflows, conditioned by executive regime type, affect the level of FDI incentives offered in democracies. I predict that labor prefers FDI and FDI incentives, while domestic capital opposes FDI and FDI incentives. Evidence from the cross-national empirical analysis in Chapter 4 suggests that democratic countries with higher levels of legislative cohesion are more likely to offer generous levels of FDI incentives. In this chapter and Chapter 6, I shift gears to take a more qualitative approach in order to explore the mecha-

nisms underpinning my theory of the politics of FDI incentives provision.[1] This chapter presents a case study of Poland, which has had a parliamentary form of government since 1997. As discussed in Chapter 2 and modeled in Chapter 3, parliamentary systems are characterized by legislative cohesion, meaning that members of a governing coalition vote together in a disciplined manner out of the fear of the coalition falling apart. The result of this disciplined voting is that spending on FDI incentives must satisfy all voters represented in the coalition. Because parliamentary coalitions are larger than presidential coalitions, more voters and thus more workers are represented. This drives up the level of FDI incentives spending in parliamentary regimes. As Poland has a parliamentary regime, I expect FDI incentives to be more generous in this country.

I first look at Poland's transition from communism in order to understand the constitution of labor and capital in the country since 1989. In particular, I seek to contextualize the attitude of labor towards FDI and FDI incentives by discussing labor weakness, party-union linkages, and the effect of labor-party links on neo-liberal reforms. I then provide an overview of deliberations between the executive and legislature over a particular episode of FDI in order to preview how legislative cohesion works with respect to FDI policy in Poland. Based on the nature of Poland's transition and the

[1] I would like to acknowledge the generous support of the Alexander Dubcek Fund (University of Minnesota) and the Andrew Dickinson Memorial Fellowship (University of Minnesota, Department of Political Science). Author interviews cited in this chapter received approval from the University of Minnesota Institutional Review Board, study number 1409E53647.

evolution of Poland's integration into the global political economy, I then characterize the preferences of labor and capital towards FDI and FDI incentives. Next, I describe Poland's executive regime type, which began as semi-presidential. Constitutional changes passed in 1997, however, converted the system into a parliamentary regime. I then discuss my operationalization of FDI incentives in the Polish case, which takes the form of the adoption and expansion of special economic zones (SEZs). Based on evidence provided, I evaluate my theoretical prediction for the Polish case. The chapter also adds a discussion of a finding from the Polish case that may have implications for theories based on the distributional consequences of FDI. A brief summary concludes the chapter.

5.2 Transition

The collapse of communism gave way to at least three simultaneous transformations in former communist countries (Przeworski 1995; Kuzio 2001). Countries like Poland faced the challenges of marketization, democratization, and institution building. Unlike other post-communist countries, such as Russia or Romania, Poland did not face the fourth challenge, that of nation-building (Kuzio 2001). After the annihilation of Poland's sizeable Jewish population during the Holocaust, the country took on a virtually monoethnic composition.

At the beginning of transition, the Polish economy differed from other

formerly socialist economies in a number of important ways. Hyperinflation was critical, external debt was immense, and labor maintained a particularly strong socio-political position. In contrast to other former members of COMECON, a quasi-autarkic trading bloc dominated by the USSR, Poland was less economically dependent on the USSR. In addition, economic centralization was less of a problem and private ownership in agriculture was greater than in other formerly socialist countries (Balcerowicz 1994).

According to Przeworski (1991), the intention of economic reforms in the post-communist period was to facilitate the creation of an economy that rationally allocates resources and in which the state is financially solvent. In order to accomplish these goals, a few key reforms were necessary. These included price deregulation, shrinking the number of monopolies, lowering or ending protective barriers, reducing state spending, more effective tax collection, and privatization. By design, these reforms lead to a fall in aggregate consumption, which hurts many societal actors. Over the long-term, however, the reforms lead to a increase in aggregate consumption. This approach led to Przeworski's formulation of the famous "J" curve.

Observing the trajectories of different post-socialist countries in the 1990s, Hellman (1998) noticed that some countries had been more successful than others in carrying out economic reforms. Hellman argues that the most common obstacles to the progress of economic reforms in post-socialist countries have come from enterprise insiders who asset strip, commercial bankers who benefit from arbitrage opportunities in distorted financial markets, lo-

cal officials eager to maintain narrow monopolies, and the so-called mafia that benefits from a continued shadow economy. In effect, these actors have endeavored to prevent additional reforms in order to accrue rents for themselves, at great cost to the rest of society. Hellman calls this the partial reform equilibrium.

Poland, however, has largely avoided the partial reform equilibrium. This success can be largely traced to the role played by the trade union Solidarity, which facilitated mass political action leading to the fall of Poland's Communist regime. According to Jowitt (1992), Poland was unique in the post-communist world for having developed a non-regime oriented mass following during the Communist period. Though the 1980 strikes marked the emergence of Solidarity as a major political actor, Garton-Ash (1999) traces the rise of Solidarity to December 1970, when striking workers at the Lenin Shipyard in Gdansk were murdered by the regime. After the 1980 strikes, Solidarity membership grew to 10 million and the foundation for the mass politics facilitating Poland's transition from communism was laid.

However, mass politics do not necessarily guarantee successful political outcomes. As Ekiert and Kubik (1999) note, mobilized masses are often considered to be dangerous carriers of anti-systemic ideologies. In Poland though, mass political protests signaled the breakdown of the authoritarian order and created a widespread sense that there were alternatives to that order. In addition, the protests gave opposition leaders a resource advantage when bargaining with authoritarian elites and provided post-socialist leaders

with a significant mandate for carrying out far-reaching economic and political reforms (Bunce 2003). In effect, Solidarity emerged as the representative of society against communism, moving beyond its identity as a trade union defending the interests of workers to a movement of the entire nation against an unwelcome political power (Bielasiak 1992).

With yet another wave of strikes engulfing Poland in spring and summer of 1988, the Jaruzelski government gave into demands for the relegalization of Solidarity and allowed partially free elections to be held in June 1989. When Solidarity took power in September 1989, with Tadeusz Mazowiecki, an anti-Communist, Catholic, and Solidarity supporter, as prime minister, the road to fundamental transformation was open (Slay 2000). In 1990, Solidarity leader Lech Walesa won presidential elections and in October 1991, Poland held entirely free parliamentary elections. The rapid change of leadership and early, successful, free elections suggest that democracy quickly took root in Poland.

Though the political and economic reforms pushed by the Solidarity-led government were not promised to be easy, the fact that transition from communism was widely supported by the population greatly assisted Poland in avoiding the partial reform equilibrium. Once the "shock therapy" economic reforms had begun, there was no going back. Although Solidarity's influence declined significantly as the bite of economic reform further depressed the Polish economy, the role of the trade union in facilitating Poland's transition cannot be underestimated.

In short, Poland's transition to market democracy took place relatively quickly. By conducting early, free elections and avoiding the partial reform equilibrium, Poland set the stage for successful long-term integration into the global political economy. Assisted by broad popular support for regime change and the painful reforms necessary for transition, Solidarity played a crucial leadership role in ensuring that Poland's steps forward were irreversible.

5.3 FDI, cohesion, and legislative/executive deliberations

In this section, I use deliberations between the legislature and executive over the passage of corporate income tax reforms in 1999 in order to preview how legislative cohesion works vis-a-vis FDI policy in Poland. Corporate income tax levels send an important signal to companies about the locational attractiveness of a country. As such, the 1999 corporate income tax reforms can be considered an episode of FDI policy in Poland.

Under prime minister Jerzy Buzek, a center-right coalition government consisting of Solidarity Electoral Action (AWS) and the Freedom Union (UW) took power in 1997. UW's senior representative was Leszek Balcerowicz, Poland's leading proponent of the shock therapy reforms in the early post-socialist period. One of Balcerowicz's key goals was to reduce both corporate income tax and personal income tax, as a way to continue Poland's

economic liberalization. After the AWS-UW government secured passage of the reforms, center-left President Alexander Kwasniewski threatened to veto the personal income tax reduction (Appel 2006), which served as one of the only times Kwasniewski intervened directly in the legislative process in this way. Balcerowicz saw the defeat of the personal income tax reform as a personal humiliation and threatened to resign (Williamson 1999). However, he ultimately remained in the coalition because his resignation would have led to the collapse of the coalition, and thus the loss of important agenda setting powers. In effect, this episode demonstrates how the pressures of legislative cohesion preserved the AWS-UW coalition government and maintained momentum to pass the corporate income tax reform. Although the main analysis in this chapter shifts the focus to a different FDI policy, special economic zones, the account described in this section helps set the stage for the discussion that follows.

5.4 Labor and politics

With the fall of communism, workers in Eastern and Central Europe (ECE) have sustained a series of setbacks to their welfare and influence. Although labor in the region has been included in neocorporatist forms, which ostensibly seek to moderate conflicting interests between labor and capital in an effort to show that cross-class cooperation leads to better outcomes for all, this neocorporatism is seen as illusory (Ost 2000). Instead of serving as

a mechanism for enhancing labor's power, neocorporatist forms in the region have legitimized labor's marginalization, declining wages, and a weakened welfare state. In Ost's (2000) view, labor in the region is weak for three reasons. First, workers have a weak sense of class identity, meaning that they do not think of themselves as needing separate organizations to defend their interests. Second, workers in private firms are skeptical of organizing out of the belief that unions will hurt their chances to benefit from the new economic system. Third, surviving unions are concentrated disproportionately in state-owned and formerly state-owned companies, which limits union reach. As such, unions have hurt themselves by lending legitimacy to neocorporatist projects aimed at advancing neoliberal economic changes that limit labor's influence.

However, Ost (2009) suggests that union revival in the coming years is more likely than ever. Among other reasons, such as EU incorporation and the end of postcommunism, today's generation of union officials in ECE is more eager than its postcommunist predecessor to defend the interests of workers and to shake conscious complicity with efforts to marginalize labor. At the same time, Ost (2009) notes that continued distrust of unions, the existence of many small firms, and issues related to the place of ECE in the global supply chain will work against union strength.

Union-party links have also had consequences for the successful articulation of worker interests. In the post-socialist context, the prevalence of legacy unions has been problematic. Under communism, unions were typically allies

of management, encouraged increased production, and often acted as social welfare agencies to workers. In a market economy, unions need to deliver concessions such as higher wages, job security, improved work conditions, and checks on management. This, however, is precisely what post-socialist unions have failed to do (Crowley 2004). The resulting lack of trust is compounded by the fact that legacy unions are often the most visible remaining institution associated with communism in post-socialist countries.

For Caraway (2008), the interaction between legacy unions and political parties has significant consequences for the shape of the labor movement. Legacy unions differ from other unions in that their existence depends on retaining state support rather than building a membership base. After democratization, legacy unions can no longer count on state sponsorship, which means that legacy union leaders may switch party allegiances in order to defend their inherited advantages. Avdagic (2004) notes that in the post-socialist context, union-party links can be characterized as an inverse dependency relationship. Put otherwise, parties have always been the strong partner and unions are willing to go along with parties, as they have little choice otherwise.

Explanations of the varying strength of union opposition to neoliberal reforms have taken a few different forms. For one, scholars suggest that labor-party links should be viewed in concert with other factors. Murillo (2000) suggests that incentives created by partisan loyalties, partisan competition, and unions explain interactions between unions and labor-oriented

governing parties over reform. In this view, partisan competition, a lack of union competition, and low partisan loyalty increase union militancy and thus opposition to market-oriented reforms. Tafel and Boniface (2003) note that government inducements and union strategic considerations also play a role in labor's response to economic liberalization. These authors assert that unions will consent to reforms only when governing elites offer material incentives that provide some compensation for short-term losses. In addition, labor leaders must consider how support for neoliberal reforms will affect rank-and-file members support. Such accountability is likely to dilute labor's support for reform.

5.5 Polish labor

Broadly speaking, representatives of Polish labor have expressed support for foreign investment. However, the decline of union density to 12%, compared to the EU average of 23% in 2012 (OECD and Visser 2013) suggests changes in union political strength in recent years. During the pre-transition and early post-transition years, Solidarity continued to act as Poland's most fundamental representative of civil society (Goodwyn 1991). At the time, Lech Walesa sought to mobilize Solidarity and its activists in favor of FDI. For Walesa, foreign investment meant new jobs, technology, management, corporate culture, and ethics, all of which would assist Poland's entrance

into the global economy.[2] Long-time Solidarity activists add that there was little choice but to accept the inevitability of foreign investment.[3]

However, an interesting pattern emerged with respect to labor union support of liberalization. One of the key features of Poland's early post-socialist history was the high degree of politicization of the country's unions, which was unmatched elsewhere in East Central Europe (Avdagic 2004). For one, Solidarity was closely allied with center-right governments in the early and late 1990s. While in support of shock therapy, Solidarity also pushed its allies in government in 1989-1990 to pass worker unemployment support as well as structural benefits such as obligations for directors of state-owned enterprises to consult with workers councils before mass layoffs (Tafel and Boniface 2003). The subsequent post-communist economic crisis, though, gave the government impetus to wind down worker support programs, which put Solidarity in a awkward position. In this context, the former regime associated trade confederation, the All-Poland Alliance of Trade Unions (OPZZ), sought to regain legitimacy by actively opposing the government and thus claiming it was a better representative of workers than Solidarity. Though this may have convinced some, once the OPZZ-allied Democratic Left Alliance (SLD) came to power in the mid-1990s, OPZZ was quick to defend liberalization measures adopted by its allies in government (Robertson 2004). As such, the politicization dynamic should be taken into account when con-

[2]Lech Walesa Institute, ”Foreign Investors in the last 25 Years,” Lech Walesa Institute 2014, Warsaw, Poland

[3]Author interviews, November 20, 2014, Gdansk, Poland

sidering union support for economic reform measures, such as FDI incentives.

With regards to popular attitudes towards greater openness and economic liberalization, most of the Polish public remained committed to transition in the initial post-communist period (Paczynska 2005). In addition, workers began to see that foreign investment improved the competitiveness of Polish firms (Domanski 2004), which increased support for FDI. More concretely, studies exist to support the contention that FDI has a positive effect on wages. Bedi and Cieslik (2002) use data from Poland from 1994-1996 to conclude that workers in industries with a higher presence of foreign direct investment enjoy higher wages. In addition, the authors find that the magnitude of the foreign presence effect increases over time, suggesting that workers in industries with greater foreign participation experience faster wage growth. Faggio (2001) uses firm-level manufacturing sector data from 1994-1997 to conclude that the entry of foreign investors into a local labor market is associated with higher average wages in companies with foreign participation as well as in domestic firms. Onaran and Stockhammer (2008) find that FDI has a positive effect on wages in Poland, but this is driven largely by the capital intensive and skilled sectors.

Despite some degree of politicized support for economic liberalization and accompanying inflows of foreign investment on behalf of unions, it appears that worker attitudes reflect the empirical evidence that FDI boosts wages. As a result, I interpret this evidence as preliminary support for my contention that labor supports FDI and FDI incentives in Poland.

5.6 Domestic business

While Poland's transition from communism saw initial increases in the power of Solidarity, the growth of a strong business class was anything but quick. As compared to other post-socialist countries, the emergence of a robust non-Communist elite and a mass social movement that was unaligned with the regime meant that potential oligarchs and asset strippers among the Communist nomenklatura would be harder-pressed to remain in power. In addition, the pace of reform in the initial post-communist period ensured that oligarchs and former communist insiders would be unable to capture sectors of the economy nor sufficiently retain political power to block change (Roland 2002). While "enfranchisement of the nomenklatura," meaning allowing communist elites to acquire state owned property prior to the major privatization efforts, did take place in Poland, it was of short duration (Nowak 1992). Even still, the awarding of assets to the former nomenklatura did not result in the formation of robust business class early on in the transition. There was no business lobby to speak of until Poland's economy gained steam in the late 1990s.[4]

At the same time, the Polish business owners who did exist at the early stages of the transition did voice opposition to FDI. As early as 1993, business elites suggested that Polish entrepreneurs should be given preference to acquire state-owned enterprises over foreign capital (Schoenman 2005). Gar-

[4] Author interviews, November 17, 2014, Warsaw, Poland

dawski (2001) adds that Polish small and medium-sized enterprises (SMEs) have felt threatened by foreign competition. There have been instances of domestic manufacturers successfully voicing opposition to foreign investment in SEZs, such as Unifi (fiber manufacturer) and Merloni (cookers manufacturer) being refused permission to locate in the Lodz SEZ (Domanski 2004).

Since the accession to power in 2007 of Platforma Obywatelska (PO), a pro-business, center-right party, Poland's business class has made its influence felt more strongly. As Naczyk (2014) notes, PO has long maintained links with PKPP Lewiatan, Poland's largest employers' association. While PO had maintained a more open attitude towards foreign capital, as the effects of the global economic crisis began to be felt in Poland, a number of key Polish business leaders, some associated directly with PO, have been using more economic nationalist language (Naczyk 2014). At the same time, representatives of the Tusk government expressed interest in promoting Polish "national champions" while also supporting measures to make foreign takeovers of Polish companies more difficult (Parkiet 2010).

At least two empirical studies provide support for the contention that FDI inflows are harmful to Polish businesses. Altomonte and Resimini (2002) use data from 1995-1998 to support the contention that FDI has a disruptive effect on domestic business in Poland. According to this view, once a foreign company is established, domestic businesses displaced by the presence of a foreign company do not automatically adjust to the new reality, which leads problems for domestic firms. In addition, using data form 1993-1997,

Konings (2001) finds that firms in Poland with foreign participation perform better than firms without foreign participation, also noting the presence of the competition effect on domestic firms.

Domestic business in Poland lacked strength in the years immediately following Poland's transition from communism, though evidence exists to suggest that domestic business was an early opponent of FDI and the use of SEZs to facilitate foreign investment. While the pro-business PO party articulated supported for foreign capital at the start of its term in office, the negative effects of the global economic crisis have seen economic populist attitudes expressed more frequently by PO leaders. Finally, there is empirical evidence to suggest that domestic businesses in Poland are hurt by foreign investment. Taken together, I make the preliminary conclusion that domestic business in Poland opposes FDI and FDI incentives, as predicted by my theory.

5.7 Poland's executive regime type

As Linz (1990) suggests, "the superior performance of parliamentary democracies is no accident." For Poland, however, the road to successful parliamentary democracy was neither direct nor short. After a brush with semi-presidentialism, Poland became a parliamentary democracy following constitutional changes passed in 1997 (Orenstein 2010). Under the 1992 interim constitution, the Polish president had power to dissolve parliament

and exercise discretion over the formation of the cabinet, which was made up of parliamentarians from the winning coalition and led by the prime minister as formal head of government.

During the semi-presidential period, the president's personality appeared to dictate the extent of tensions between president and parliament (Zubek 2011). Jaruzelski, the former communist leader, held the presidency from 1989 to 1990 and exercised far-reaching restraint. Lech Walesa, the former Solidarity leader, sought to maximize his powers at the expense of parliament and regularly blocked cabinet-led legislative efforts. This eventually resulted in a government crisis in 1995 and the replacement of the then prime minister, Waldemar Pawlak (Wiatr 1997). The election of Alexander Kwasniewski in 1995 marked the beginning of a more passive presidency (Jasiewicz 1999). The 1997 constitution, among other changes, removed the president's power to be consulted on executive appointments and the ability to reject requests by the prime minister for appointing or dismissing ministers. In addition, the president lost the budget veto as well as the rights to chair the cabinet and otherwise influence cabinet decisionmaking (Zubek 2011). It is safe to say that Poland's executive regime type, after 1997, can be classified as parliamentary.

5.8 Special economic zones in Poland

One of the tools Poland has successfully used to attract FDI has been special economic zones (SEZs). According to Ge (1999), an SEZ is a geographical area within a country where economic activities of a particular kind are promoted by a set of policy instruments that are not generally applicable to the rest of the country. In other words, a government that actively uses SEZs may be seen as conducting economic policy in such a way that favors certain geographical regions, economic activities, and interest groups over others. That said, via the investment flows attracted, SEZs can generate new jobs, export growth, technology transfers, integration of foreign and domestic industries, diversification, increased economic openness, and better quality jobs (Saydikaharov 2012). The zone established in Shannon, Ireland in 1959 is often touted as archetypal, having attracted a large number of multinational corporations over the years (Chen 1995).

In Poland, SEZs were introduced as instruments of regional policy, seeking to address structural unemployment resulting from the shuttering of large, inefficient state-owned enterprises. After a team of Irish and Polish experts drafted a plan for the first Polish SEZs between 1992-1994, the foundational law for the SEZs was passed in 1994. According to Gwosdz et al. (2008), areas eligible for SEZs were originally the old industrial regions requiring deep restructuring (Upper Silesia, Lodzki, Sudecki, and Staropolski wojwodectwa), urban areas with industrial monoculture, agricultural regions

dominated by former large state-owned farms in northern Poland, and underdeveloped agricultural regions in eastern Poland exposed to recession and social deterioration. In addition to brownfield projects, which are aimed at redeveloping old industrial sites, SEZ policy has also sought to encourage new, "greenfield" projects as well.

Companies are encouraged to take advantage of the SEZs in Poland through preferential tax treatments, such as tax holidays and import duty exemptions, as well as non-tax incentives that often pertain to employment and licensing (Guagliano and Riela 2005). SEZs also offer infrastructure and access to transportation networks. Poland's 14 SEZs were established between 1995 and 1997, with the first SEZ opening in the industrial town of Mielec, a town of 60,000 where the major employer, an aircraft factory, had gone bankrupt (Gwosdz et al. 2008). To date, SEZs have an impressive track record of attracting large multi-national corporations, such as Saint-Gobain, Fiat Powertrain Technologies Poland, Dell, Procter and Gamble, Mondi Packaging Paper Swiecie, Sharp, Swedwood Poland, LG Electronics, Shell Polska, and Rockwool Polska (PAIZ Poland 2014).

As the evidence below shows, the Polish government has supported SEZ development, regardless of the political affiliation of the party in power. The foundational law on SEZs[5] was passed by the Polish Parliament under the leadership of a coalition government headed by the Democratic Left Alliance

[5] Act of 20 October 1994 on special economic zones (Journal of Laws of 1994, No. 123, item 600

(SLD), the successor party to the Communist Party, and the Polish People's Party, which can be described as centrist, Christian Democratic, and agrarian. A series of amendments, passed by subsequent governing coalitions with respect to the foundational SEZ law, demonstrate continued support for the SEZs. In 2000, the center-right Solidarity Electoral Action (AWS)-led government passed an amendment[6] that both limited state assistance to companies as per EU accession requirements, but applied the cuts only to companies investing after December 31, 2000 (Kislowska 2006). An amendment[7] passed by the SLD-led governing coalition in 2003 to harmonize Polish law and policy with EU accession requirements was accompanied by provisions that added real property tax exemptions for qualified enterprises in SEZs. The amendment also extended incentives for SMEs under the foundational law until 2011. In 2008, the center-right PO-led government passed an amendment[8] extending the legal life of the SEZs until 2020 as well as increasing the physical size of the zones. Most recently, the PO-led government passed a regulation[9], akin to an executive order in the U.S. system, that has extended SEZ activity until 2026.

[6]Act of 16 November 2000 on amendments to the Act on special economic zones and amendments to certain other acts (Journal of Laws of 2000, No. 11117, item 1228)

[7]Act on Special Economic Zones of 20 October 1994, Journal of Laws No 188/2003, item 1840)

[8]Act on Special Economic Zones of 20 October 1994 (Journal of Laws of 2007, no. 42, Journal of Laws 0f 2008, no. 118, item 746)

[9]Regulation of Council of Ministers 23 July 2013 on Changes to Regulations of the Special Economic Zones, items 968-981, 1007

Figure 5.1: Special Economic Zones in Poland

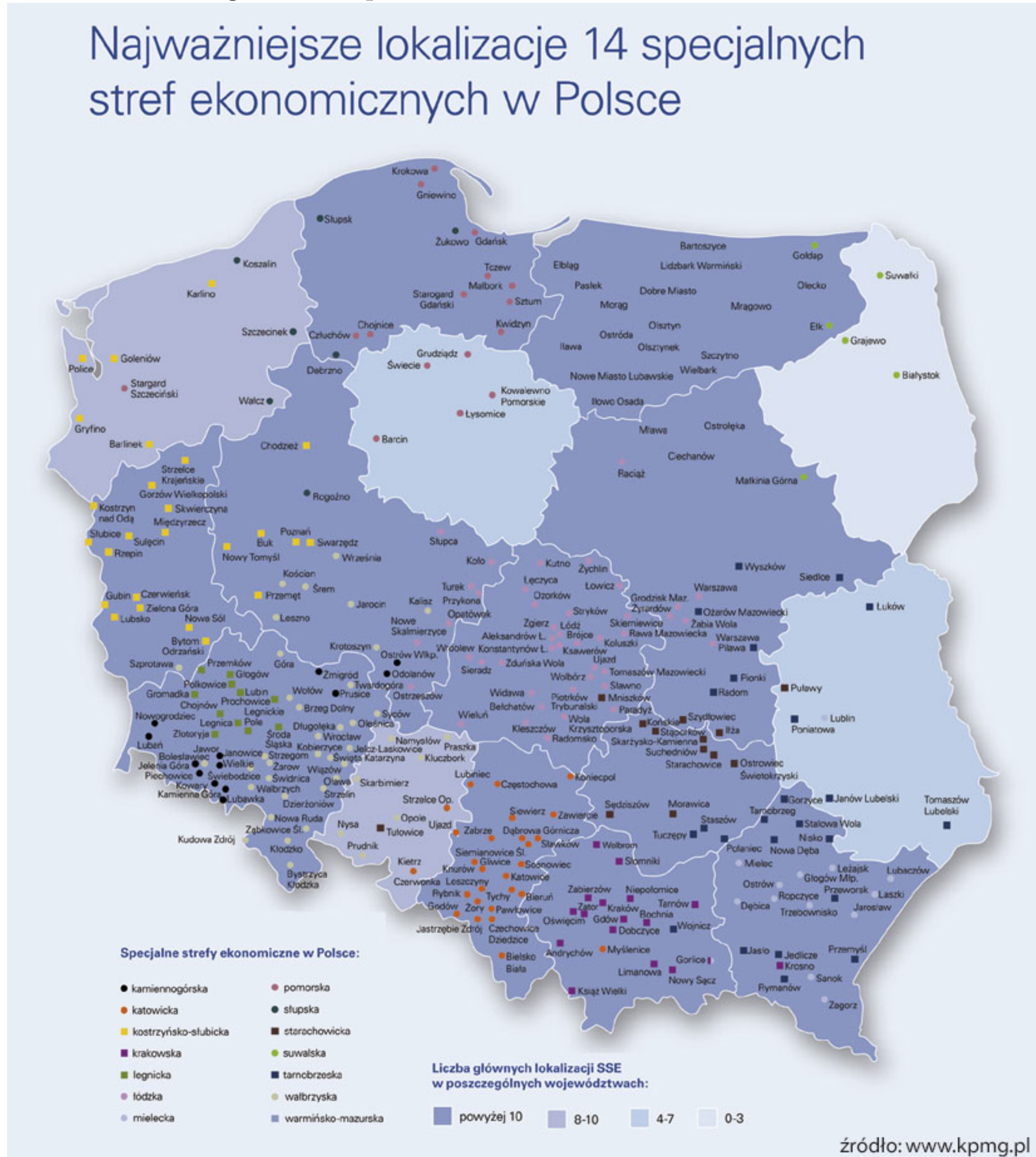


Figure 5.1 depicts the proliferation of SEZs in Poland. What is most

striking about the map is how SEZs have been allowed to expand beyond their initial geographic locations. The Pomeranian SEZ, originally based near Gdansk in northern Poland on the Baltic Sea, serves as prime example. The Pomeranian SEZ is denoted by green dots in Figure 5.1. At the moment, the Pomeranian SEZ includes territory in towns such Chojnice and Kwidzyn, which are located 128 kilometers and 103 kilometers from the original Pomeranian SEZ, respectively. Although these towns are not contiguous to the Pomeranian SEZ located near Gdansk, they are legally attached to it. The seemingly unfettered growth of SEZs suggests that they are politically popular due to success in attracting investment and jobs, which help to improve local economic conditions. According to KPMG (2014), Poland's SEZs feature companies employing nearly 280,000 people, while the total area covered by SEZs in Poland amounted to 16,200 hectares in 2014.

5.9 Cohesion or consensus?

In previous sections, I find preliminary support for my theoretical expectations about the preferences of labor and domestic business towards FDI and FDI incentives, namely that labor is supportive and domestic business is opposed. I also establish that Poland's executive regime type has been parliamentary, since 1997. Additionally, I establish that support for one type of FDI incentive, SEZs, has been in place across party lines and political coalitions for many years. On one hand, the socialist left, represented

by the SLD, has supported SEZs. The center-right AWS, the political arm of Solidarity, also has supported SEZs. Finally, the centrist PO, with its pro-domestic business bent, has repeatedly extended the life of SEZs. This evidence suggests support for my theoretical prediction that Poland's parliamentary system facilitates stable, consistent support for higher levels of FDI incentives.

However, this tentative conclusion must be reconciled with two issues. First, I note above that support for SEZs has been provided recently by the pro-domestic business PO party. The assumptions I make about the distributional consequences of FDI inflows suggest that domestic business and thus parties representing domestic business would oppose FDI incentives, such as SEZs. However, this has not been the case with PO. Second, the initial policy moves that introduced SEZs to Poland took place under a semi-presidential system, in 1994. During the semi-presidential period, severe conflicts between president and parliament were underway, which eventually brought down the government in 1995. My theory predicts, by contrast, that low legislative cohesion under Poland's semi-presidential system would have made policy changes favorable to labor more difficult. As a result, the timing of the first SEZs legislation remains an issue with respect to my theoretical approach.

One explanation to these issues is that the timing of the SEZs creation and broad political support for them may be less surprising given domestic political consensus about the country's need to attract foreign investment in

the early post-transition years. According to a current member of the Polish parliament,[10] an official from the National Bank of Poland,[11] and Solidarity activists,[12] consensus across the political spectrum is the reason for consistent support for SEZs and FDI incentives generally in Poland.

While my predictions about the preferences of labor and domestic business with respect to FDI and FDI incentives as well as my contention that Poland's parliamentary system would engender stable coalitions in support of FDI incentives, a few questions remain. Additional research is needed into the reasons why the initial SEZ legislation was rolled out in 1994 and why the PO government has supported SEZs.

5.10 Agriculture

Despite the apparent political consensus about FDI and FDI incentives in Poland, there are significant interests opposed to FDI inflows to particular sectors of the economy. Strong resistance to FDI in Poland was and can continue to be found in the country's agricultural sector. As compared with the Soviet Union and other former Warsaw Pact countries, Polish farmers successfully resisted agricultural collectivization to a great extent (Szurek 1987). The collectivization that did take place happened in western Poland on territories claimed from Germany after World War II, but this accounted

[10] Author interview, October 31, 2014, Cambridge MA
[11] Author interview, November 17, 2014, Warsaw, Poland
[12] Author interviews, November 20, 2014, Gdansk, Poland

for a relatively small portion of Poland's agricultural land. As such, most of Poland's agricultural land remained in the hands of small family farms throughout the communist period (Dries and Swinnen 2004).

As plans for restructuring the Polish economy in preparation for the transition from communism took place, Polish farmers were at the forefront of resistance to reforms (Tridico 2007). According to Nowak (1992), Polish farmers were both highly organized and heavily opposed to restructuring. Given the small size of most Polish farms around the time of transition, the introduction of market reforms and opening up of the Polish agricultural sector would have laid bare the significant inefficiency of Polish farms. Modernization of agriculture in Poland would require the elimination of many farms, the necessity of population shifts as well as changes in occupation and the traditional lifestyle of a large part of the rural population. It follows, then, that farmers saw radical reform as a threat to not only their economic well-being, but also to their culture and lifestyle. Indeed, as Zarycki (2000) notes, Polish farmers fear global competition and are absolutely unready to abandon the villages they have worked for generations, having previously resisted successfully several periods of economic and political repression.

While the opening of the Polish economy to market forces, spurred in large part by the country's EU membership, has brought about some degree of liberalization of the country's agricultural sector, farmers and their political representatives have prevented large scale restructuring and foreign investment to the sector. The main tool farmers have used to slow restructur-

ing has been stringent land-ownership rules, which are set to expire in 2016, following agreement with the EU after Poland's accession (Banski 2004). Politically, agricultural protectionism has been the mainstay of the Polish People's Party (Polskie Stronnictwo Ludowe).[13] The Polish People's Party (PSL) is the direct heir of the Zjednoczone Stronnictwo Ludowe (United Peasants Party), which was one of Polish Communist Party's main allies. The appeal of the PSL is primarily in its commitment to retaining the traditional mode of farming in Poland (Ingham and Ingham 2004; Jasiewicz 2008; Pienkos 2010). The PSL has advocated larger government subsidies to agriculture and has resisted modernization efforts (Jackson, Klich, and Poznanska 2003). Most recently, the PSL advanced a bill in the Polish Parliament that authorizes a state body, the Agricultural Property Agency, to serve as an intermediary for all land purchases to sellers whose current holdings do not border that land targeted for acquisition.[14] The bill, supported by PO, PSL's coalition partner, would basically place state veto power over agricultural land sales. In effect, the bill continues Poland's long-standing agricultural protectionism to the purported benefit of PSL's main constituency, despite evidence that FDI inflows to Polish agriculture may have economy-wide benefits (Dries and Swinnen 2004).

[13]Author Interviews November 17, 2014; November 18, 2014; and November 19, 2014, Warsaw, Poland

[14]Gazeta Wyborcza "Ziemia tylko dla rolnikow. PSL nie chce spekulacji, 9 Jan 2015

5.11 Conclusion

In this chapter, I have examined the mechanisms of my theory in the context of Poland. I first discuss an episode of legislative/executive deliberation around a specific FDI policy, the passage of corporate tax reform in 1999. I use this episode to preview how legislative cohesion works in practice with respect to FDI policy. I find preliminary evidence in support of my contentions that labor supports FDI and FDI incentives, while domestic business opposes FDI and FDI incentives. I also show that Poland's parliamentary system has produced stable, consistent coalitions in support of one type of FDI incentive, special economic zones (SEZs). However, the timing of the initial rollout of Poland's SEZs policy and recent support for SEZs by the pro-business PO party raise important questions. As a result, I posit that the findings in this chapter provide only tentative support for my theoretical prediction that high levels of legislative cohesion in Poland's parliamentary system have led to stable, consistent support for FDI incentives in the country.

My analysis of the Polish case has produced an interesting result that may have consequences for political economy models of the distributional consequences of FDI inflows. These models, such as the one used in this dissertation, include two actors: labor and capital. However, Poland's traditional agricultural sector has clearly and successfully opposed FDI, given the likely negative distributional consequences the sector would face under

greater openness to global competition. As agriculture retains a shrinking share of global GDP,[15] it may be unsurprising if opposition to FDI is driven by agricultural interests in other countries as well. I examine the theoretical implications of this finding in Chapter 8.

In Chapter 6, I turn to an examination of preferences towards FDI and FDI incentives, executive regime type, and FDI incentives provided in the context of Romania's semi-presidential system. Romania's transition from communism, which lacked the mass political character of Poland's, empowered the former Communist elite, and did not feature initial, robust economic reforms. Mass support for economic change in Romania was significantly more tepid, while the domestic business elite maintained suspicions about FDI. In this context, I show that Romania's semi-presidential system, embodying low levels of legislative cohesion, has led to low levels of FDI incentives in the country.

[15]World Bank, World Development Indicators 2014

Chapter 6

Semi-presidentialism and FDI incentives in Romania

6.1 Introduction

The empirical evidence I present in Chapter 4 provides tentative support for my central hypothesis, that in democracies with higher levels of legislative cohesion, FDI incentives are provided at more generous levels. In Chapter 5, I begin a case comparison exercise by examining the mechanisms of my theory in the context of Poland. I find preliminary support for my theoretical predictions regarding the distributional consequences of FDI inflows in Poland. In other words, I produce evidence suggesting that labor has been supportive of FDI and FDI incentives, while domestic business has opposed FDI and FDI incentives. I also demonstrate that Poland's parliamentary

system has been associated with stable, consistent coalitions that support one type of FDI incentives, special economic zones (SEZs). However, this evidence is accompanied by a few important caveats.

In this chapter, I turn the focus to Romania, which is a semi-presidential democracy and like Poland, a member of the European Union. I expect that in the context of Romania's semi-presidential system, which features low legislative cohesion, that the level of FDI incentives will be lower. Romania's semi-presidential system means that executive and legislature and separately elected, which facilitates unstable coalitions. These unstable coalitions make consistent for FDI incentives more challenging, as detailed below.

The rest of the chapter is organized as follows. I first examine Romania's transition from communism in order to provide context about the attitudes of labor and domestic business in the country towards FDI and FDI incentives. I next characterize an episode of legislative/executive deliberation which helps to preview how low legislative cohesion affects FDI policy in Romania. Then, I describe Romania's executive regime type, which is semi-presidential with presidential tendencies. I next discuss my operationalization of FDI incentives, namely the adoption and expansion of industrial parks (IPs). These are functionally the same as SEZs, which I demonstrate below. Based on the evidence provided, I evaluate my theoretical prediction. I conclude with a summary of findings.

6.2 Transition

As noted in Chapter 5, the end of communism meant at least three simultaneous transformations in former communist countries, including democratization, marketization, and institution-building. While Poland did not face the challenge of nation-building, the presence of significant minority populations, including Hungarians, Roma, and Germans, has made national cohesiveness more problematic in Romania. According to Vachudova and Snyder (1996), Romanians are particularly suspicious of Hungarians. From 1878 until the end of the Habsburg monarchy in 1918, the lands of Transylvania were under Hungarian rule. The Treaty of Trianon restored Transylvania to Romania in 1920, but Hungary regained control in 1940 under the terms of the German and Italian-backed Vienna Award. After World War II, Romania regained the territory, but Romanian suspicions about the threat Hungarians posed to the Romanian state have yet to dissipate.

In the 1970s and 1980s, Romanian dictator Nicolai Ceausescu carried out a brutal anti-Hungarian campaign. As part of a massive forced resettlement campaign, thousands of Romanians were resettled in Transylvania and many Hungarian villages were emptied. One of the results of the campaign was that Hungarians were left a minority in districts where they had previously been the majority (Vachudova and Snyder 1996). The collapse of the Ceausescu regime in 1989 saw the emergence of an ethnic Romanian extremist group, Romanian Cradle, which had a hand in anti-Hungarian ri-

ots which caused the deaths of a still unknown number of Romanians and Hungarians in March 1990. State-run media outlets and the transitional government, led by the so-called National Salvation Front (NSF), dominated by former nomenklatura, took strikingly anti-Hungarian positions, which set the tone for deep distrust between the state and the Hungarian community in the early post-transition years. In 1996, however, a broad coalition led by the Democratic Convention of Romania (CDR) defeated the NSF-successor Party of Social Democracy in Romania (PDSR). The CDR-led coalition included the Hungarian minority party and promoted widespread tolerance of minorities (Spendzharova and Vachudova 2012). Then, in 2000, parties across the political spectrum came together in opposition to the strong showing of the nationalist, anti-Semitic, anti-Hungarian, authoritarian Corneliu Vadim Tudor in presidential elections (Tismaneanu and Kligman 2001). The election of Klaus Iohannis, a member of Romania's once prominent German minority, as president in 2014 serves as further evidence pointing to growing national cohesiveness in the country.

While Romania may be well on the way to resolving ethnic tensions, political and economic progress have been less clear, nearly thirty years after the fall of communism. Gallagher (2005) asserts that Communist Romania under Ceausescu possessed more attributes of a totalitarian dictatorship than any of the other East European party-states. In this view, the more intense the authoritarian experience, the greater the presence of an administrative class which is entirely unwilling to let go of power. Indeed, the remarkably

quick capture, trial, and execution of Ceausescu and his wife was arguably done in order maintain silence about the crimes committed by Romania's post-communist leaders, all of whom were members of the nomenklatura. Although mass protests ultimately brought down Ceausescu's regime, former Communists in the guise of the NSF swiftly took advantage of the political vacuum (McFaul 2002). In contrast to other post-communist countries, there were no pacts, no negotiations, and no compromises during the initial transition (Welsh 1994). Newly emerging political actors were intensely fragmented and unable to participate as equals in talks with the former Communists. As a result, the NSF triumphed in Romania's first post-communist elections in May 1990 and was able to form a government without participation by any opposition groups.

Tismaneanu (1993) characterizes the immediate post-Ceausescu period as featuring many elements that had been part of the political style of the Communist bureaucracy. These included a quasi-charismatic party/movement with a strong leader opposed to impersonal democratic procedures and regulations; promotion of the majority ethnic population at the expense of minority groups; hostility to market capitalism; and regime anxiety demonstrated by a strong rhetoric of solidarity that insists on the need for Romanians to close ranks against all alleged foreign conspiracies. The main tools for achieving this state of affairs were NSF leader and Romanian president Ion Iliescu's political cadres, the economic oligarchy recruited from the ranks of ex-domestic intelligence officials, government controlled media, and the emer-

gence of fundamentalist-populist political groups that served to "moderate" Iliescu's views.

Until 1996 and 1997, when Iliescu and his supporters were defeated in national elections, there were few meaningful reforms (Ibrahim and Galt 2002). In coming to power in 1996 and 1997, the opposition CDR promised to regulate property rights, speed up privatization, and improve the business climate. However, these efforts were thwarted by entrenched former Communists and the state continued to control most the economy even by 2000 (Mungiu-Pippidi 2003). In part due to continuing economic hardship as well as rampant political infighting and perceived ineffectiveness, the CDR-led coalition was rejected by the electorate in the late 1990s, paving the way for the return of Iliescu.

For a number of scholars, the defeat of Iliescu's chosen successor in the 2004 elections, marked the end of the post-socialist transition in Romania and represented determined steps towards democratic consolidation (Gross and Tismaneanu 2005; Stan 2005; Downs and Miller 2006; King and Marian 2014). While it appears that Romania has made progress towards political normalization, helped in part by the need to meet requirements for accession to the European Union, Pop-Eleches (2008) points out that Romania's political scene has been dominated by two major parties, both of which succeeded the NSF. In other words, Romania stands out as the only democracy in Europe where representatives of the Communist successor parties have been participants in nearly every government since the fall of Commu-

nism. The two dominant parties in contemporary Romanian politics are the Social Democratic Party (PSD) and the Democratic Liberal Party (PDL). While the PSD has a center-left orientation and the PDL has a center-right orientation, both emerged from the NSF. Following the November 2014 presidential elections, the PDL merged with the pre-communist National Liberal Party (PNL), from which the current Romanian president, Klaus Iohannis, was elected. The influence of communist successor parties in Romania will unlikely diminish in years to come.

Romania's authorities have pursued a particularly uneven approach to economic reform since 1989. As with other former members of COMECON, Romania suffered from the loss of established trade and supply chains as well as new pressures from international competition with the fall of communism. To make matters worse, Romania's economy was one of the most highly centralized in Central and Eastern Europe. This meant that reforms needed to go particularly deep in order to facilitate the marketization of Romania's economy. Though the initial post-communist Prime Minister Petre Roman sought to engage in extensive economic reforms, reluctance on the part of President Iliescu and his supporters ultimately thwarted any serious reform efforts (Gallagher 2005).

Until the election of the opposition CDR in 1996, Romania's economic reform was complicated by frequent delays and reversals. This of course did little to endear the country to foreign investors. The situation was further complicated by the fact that Romania's former communist political class

continued to see the state as a source of economic accumulation. Foreign competition, then, would only pose problems to Romania's grossly inefficient and non-competitive state-run companies. The opposition victory in 1996, though, disrupted the formation of an all-powerful economic oligarchy in Romania. Had the opposition not taken power, even if weakly, it appears likely that Romania would have fallen victim to Hellman's (1998) partial reform equilibrium.

Accession discussions with the European Union greatly assisted subsequent efforts to reform Romania's economy.. Despite the resumption of power by Iliescu and his cadre of ex-communists in 2000, EU membership remained a highly desirable goal across the Romanian political spectrum. Romania's progress in meeting the EU's accession criteria was slow, particularly with respect to economic reforms, such as facilitating a functioning market economy and building capacity to face the pressure of competition and market forces within the EU (Constantin, Goschin, and Danciu 2011). After a two year delay, Romania received EU membership in 2007. EU accession prospects and a favorable external economic environment led to Romania's experiencing continuous growth until 2008, when the effects of the global financial crisis finally hit. According to Voinea and Mihaescu (2009), Romania's crisis can be traced largely to structural problems, which have been exacerbated by external factors. It is possible that Romania's uneven reform path, overshadowed by eight years of economic growth during the first decade of the 2000's, has returned with a vengeance.

In contrast to Poland, Romania's transition from socialism has been much more uneven. A multi-ethnic society, Romania has faced the challenging prospect of nation-building alongside political and economic transitions, while Poland's monoethnic composition obviated the need for nation-building. Romania's incomplete break with the communist past, in contrast to Poland's relatively clean transition, is evidenced by the continuing power of two communist successor parties in Romanian politics. In addition, repeated delays in economic reform distinguish Romania's post-socialist economic trajectory from that of Poland.

6.3 FDI, cohesion, and legislative/executive deliberations

In Chapter 5, I used legislative/executive deliberations around the passage of corporate income tax reform in 1999 in order to preview how legislative cohesion works in practice in Poland. The ultimate result was that corporate income tax reform, an important signal to foreign investors, was passed. While the reform package proposed fell significantly short of what a key member of the governing coalition wanted, this politician ultimately choose to support the reforms, remain in the coalition, and retain key agenda setting powers. By contrast, I present an episode of legislative/executive deliberation from Romania focusing on economic liberalization, which has consequences for FDI inflows into the country. Although this discussion does not

focus on a specific instance of FDI policy, it is illustrative of how low legislative cohesion leads to weaker FDI policy under Romania's semi-presidential system.

Despite the fact that they originally had a shared political home in the ex-communist NSF, Romania's first president, Ion Iliescu, and prime minister, Petre Roman experienced significant conflict soon after being elected in 1989. With significant powers allocated to both president and parliament, Iliescu and Roman were constantly battling to take credit for successes and blame each other for failures. The split between Iliescu and Roman worsened to the point where Iliescu's supporters formed a breakaway party in 1991 (Baylis 1996). One particular locus of conflict was the pace of economic liberalization. According to Jeffries (2002), Roman sought a "leap to the market economy." By contrast, Iliescu favored a more gradualist approach, which slowed liberalization reforms considerably (Turnock 2007). After Roman turned up the heat on Iliescu, Bucharest was invaded by thousands of angry miners from the Jiu Valley, who forced Roman's resignation as prime minister. Although Roman's replacement as prime minister, Theodore Stolojan, managed to push through limited reforms, Iliescu served as a major block (Carothers 1997). This brief description helps to show that low legislative cohesion in the country's political system had negative consequences for economic liberalization reforms, which sent a signal to foreign investors about the locational attractiveness of Romania as an FDI destination.

6.4 Romanian Labor

In 1989, a vast majority of Romanians appeared ready to accept the goal of marketization, but wanted to avoid the difficult consequences of reform. By contrast, initial support for marketization and acceptance of the consequences was stronger in Poland. Supporters of the ex-Communist NSF, which governed the country in the immediate post-communist period, included blue-collar workers in inefficient industries that had little chance of competing successfully against external competition. However, labor unions supported and encouraged market reforms, even as strikes took place against the negative effects (Gotia 2011). While structural conditions, such as corruption and the slow pace of reform limited FDI inflows in the early post-communist period, popular attitudes towards foreign capital began to change as FDI inflows picked up steam in the mid-1990s (Gheorghiu and Gheorghiu 2011). Similar to Poland, empirical evidence exists to suggest that FDI has a positive effect on wages in Romania. Using data from 2002-2009, Mutascu and Fleischer (2010) find that FDI levels are positively associated with wages in Romania.

Romanian trade unions successfully affected state policy in the early post-transition period. In the years of uneven economic reform during Iliescu's first term as president, unions were able to stop plant closures and limit the effects of price liberalization. After the former trade unionist Victor Ciorbea became prime minister following the opposition victory in 1996,

union influence arguably reached its peak. Generally speaking, Bohle and Greskovits (2012) maintain that Romanian trade unions have relatively high mobilization power. To this point, Trif (2010) notes how Romania had a comprehensive industrial relations system with widespread collective bargaining at national, sectoral, and company levels and with the legal system supporting bipartite and tripartite consultations and negotiations between trade unions, employers, and government. However, Trif (2013) points out that in recent years the Romanian government has radically overhauled the system, forcing a decentralization of collective bargaining and making it more difficult for unions to bargain collectively, basically leveraging the fiscal pressures of the 2008 recession to push back against the unions. Though unions were able to oppose privatizations and push through renationalizations, privatization and industrial restructuring greatly expanded in subsequent years (Varga and Freyberg-Inan 2014). Despite some union opposition to aspects of economic reform, other unions strongly supported privatization and FDI. According to Ban (2011), Cartel Alfa, a national trade union with an estimated 325,000 members, has been an ardent proponent of privatization to foreign investors. Compared to Poland's highly politicized trade unions, Romanian unions appear to have been more consistent in supporting or opposing foreign investment. Though trade unions have exerted significant influence in Romanian politics, the close connections between particular trade unions and political parties never took on the same intensity in Romania. Also compared to Poland, union density remains much higher, at 33% (OECD

and Visser 2013). In light of the evidence provided here, I suggest that only partial support exists for my contention that labor supports FDI and FDI incentives in Romania.

6.5 Domestic business

As noted above, the role of the ex-Communist nomenklatura in the political and economic life of post-socialist Romania cannot be understated. Members of the administrative elite, having seen the writing on the wall with respect to the end of communism in Romania, began converting their administrative power into economic control. Unlike Poland, Romania had a business class right at transition, as the former communists took advantage of the power vacuum to develop significant business interests. One approach was to create lucrative subcontracting relationships with small private firms in which managers of state enterprises had a personal interest. Once privatization began, the power of these enterprise managers only grew (Stoica 2004). In addition, early reforms enabled predatory elites to seize directly or indirectly significant holdings in state-owned enterprises. As Noutcheva and Bechev (2008) note, key figures from the political establishment, particularly the NSF, developed patron-client relationships that facilitated the movement of substantial state resources into loss-making public sector and quasi-private sector companies. According to Dorobantu (2010), many of the so-called oligarchs who built their business empires in the early transition years continue

to be closely associated with the center-left NSF successor party, the PSD. In the 2009 presidential election, the close relationship between the PSD candidate, Mircea Geoana, and a number of Romania's oligarchs may have adversely affected Geoana's electoral fortunes. As it turned out, Geoana had made a house call to one of the oligarchs the night before the final presidential debate.

It may be fair to refer to post-socialist Romania as exhibiting political capitalism, meaning capitalism built not on but with the ruins of socialism (Stoica 2004; Bluhm and Trappman 2008). Although Poland too experienced an influx of ex-nomenklatura into the private sector, shock reforms and a relatively clean political break with socialist makes the political capitalism thesis less relevant in the Polish context. Vachudova (2005) calls the first seven years of the Romanian transition "a textbook case of the capture of a partially reformed economy by former communist cadres linked closely to the ruling political parties." The period between 1996 and 2000, when the anti-communist CDR coalition ruled, is also considered a disappointment from the view of economic and state reform (Gallagher 2005; Pop-Eleches 2005). In addition, Pociovalisteanu (2008) suggests that incomplete reforms in the early postcommunist period facilitated the development of a special form of post-socialist capitalism, in which political clientilism plays a major role.

According to Young (2010), the increased competition faced by Romanian entrepreneurs in recent years as well as political changes and banking reform have combined to weaken the political power of the old nomenklatura

business elite. In this view, the Romanian economic elite no longer consists mainly of communist-era enterprise managers with little market acumen, who require political connections for success and take advantage of uncertainty surrounding property rights and market institutions. Instead, Young argues that Romania's contemporary business elite consists of individuals who were relatively young at the beginning of transition and who have learned the rules of market capitalism quickly. While these new elites almost assuredly benefitted from shady privatization deals and government contracts, exploitation of corrupt links to state is not the primary mode of operation for Romania's new business elite.

Empirical evidence exists to suggest that domestic business in Romania may have been wise to oppose foreign investment. Similar to Poland, a number of studies indicate that FDI has adverse effects for domestic business in Romania. First, Konings (2001) uses data from 1993-1997 to find evidence of a significant competition effect from foreign firms on domestic firms. Altomonte and Pennings (2009) analyze data from 1995-2001 to find that the competition effect becomes a particularly significant problem after FDI levels reach a certain point.

With regard to attitudes towards FDI, Verdery (2002) contends that anti-foreign capital attitudes have been strong among Romania elites. Verdery claims that relative economic backwardness in Romania obstructed the possibilities of enrichment through the market, which led to protectionist views of FDI. Stoica (2004) adds that the ex-nomenklatura needed time to con-

vert their political capital, organizational experience, and managerial skills into economic capital, and, therefore, had no interest in an early and radical break with the past. This translated into suspicious attitudes towards FDI in the early post-transition years.

However, this status quo begin to dissolve in the early 2000s as Romania began serious negotiations with the EU regarding eventual accession. According to Stoica (2004), the PSD oligarchy in the early 2000s gave lucrative infrastructure projects and sold premium state factories and banks to key west European companies. At the same time, though, Ganev (2013) points out that the opening of Romania to FDI should not be construed as the entrance of honest foreign investors seeking to contribute to the rule of law and market development in Romania. Instead, successful foreign investors were high bidders who could make offers that corrupt officeholders found appealing. The above suggests reasonably strong support for my contention that domestic business in Romania opposes FDI and FDI incentives.

6.6 Romania's executive regime type

Despite some ambiguity, the prevailing view holds that Romania has a semi-presidential executive regime type (Elgie 2007; Vergottini 2012; Gilia 2013; Tomescu and Levai 2013). A simple reading of the Romanian constitution suggests that the French constitution of 1958 served as the model. Duverger (1980) notes that the semi-presidential system is one in which the

president, who is directly elected by the people, becomes a referee between state powers, while executive authority actually belongs to the government, which is led by the prime minister. According to the Romanian constitution, the president is elected in a direct vote by the electoral body, as is Parliament. This implies that both president and parliament enjoy the same popular legitimacy. Yet, parliament is characterized as "the supreme representative body of the Romanian people." While the government is politically liable only before Parliament, the president has the constitutional right to designate candidates for prime minister as well as the right to appoint a government following the parliamentary investiture vote. In addition, the president may dissolve parliament when certain circumstances are met. At the same time, the president must cooperate with other state authorities, such as parliament, the government, or judiciary in order to exercise his responsibilities.

Prior to the 2003 constitutional reforms, both president and parliamentarians enjoyed terms in office of similar length. However, the 2003 reforms sought to limit the role played by the president in influencing parliamentary elections by extending the president's term in office to five years. By law, the president is not allowed to be member of a political party. Even still, Draganu (1998) probably remains correct in suggesting that the "ban on the president being a member of a political party was bound to be just on paper. Even if, after the elections, the president will not be the formal leader of the political party on whose support he won, he will continue to be the invisible

guide of his party, at least in terms of the most important political matters."

Conflict between president and Parliament has been an ever-present issue in Romanian politics since the fall of Ceausescu. For most of Romania's postcommunist history, successive presidents have sought to expand the power of the presidency, while Parliament and government seek to retain whatever constitutional discretion that may be available. Unfortunately, constitutional ambiguity, combined with strong personalities in the political arena have meant that instability and uncertainty are the key features of Romanian politics (Tananescu 2013). Similar to the acrimony described above between Iliescu and Roman in the early 1990s, Romania continued to experience conflict between president and legislature during the supposedly reformist presidency of Emil Constantinescu, 1996-2000. After the failing to make good on his electoral promises, prime minister and ostensible Constantinescu ally Victor Ciorbea was quickly forced from office. Once out of office, Ciorbea publicly blamed Constantinescu for the failures of reform. Constantinescu also faced further dissent from his supposed allies in Parliament, who helped prevent any additional reforms Constantinescu had promised the public (Gallagher 2005). Most recently, the presidency of Traian Basescu was marred by serious conflict between president and Parliament after Basescu tried to manipulate important parliamentary appointments. In response, parliament voted in 2012 to suspend Basescu for abuse of powers (Tananescu 2013). In sum, conflict between president and Parliament as well as low legislative cohesion in Romania have been the cause of serious political in-

stability and uncertainty.

6.7 Industrial parks in Romania

Similar to Poland's strategy of constructing a network of special economic zones (SEZs), Romania has embarked on efforts to attract foreign investment in the guise of industrial parks (IPs). In light of Romania's ongoing de-industrialization, policymakers have sought to use IPs in order to attract new jobs to areas affected by the economic restructuring (Popescu 2010). However, development of IPs in Romania only began in 2002 with the passage of Law 490/2002 "Regarding creation and function of industrial parks," compared to Poland's start date of 1994. The law defines an industrial park as a "delimited area in which economic activities, scientific activities, industrial production activities, services and scientific research, and/or technological development valorization are development, specifically facilitating working conditions, to render valuable the human and material zone potential" (Popescu and Ungureanu 2008). Incentives for businesses, as stipulated by Law 490/2002, include income tax, local real estate tax breaks, and other local government tax incentives, as well as delays in value-added tax (VAT) payments for materials and capital equipment installed in the IP. The incentives offered in Romanian IPs resemble those provided in Polish SEZs. The law was passed under the tutelage of Prime Minister Adrian Nastase, with the approval of President Iliescu. It should be noted that both

Nastase and Iliescu represented the post-communist successor party PSD and shared a relatively strong working relationship. This stands in contrast to the otherwise fractious political scene in Romania, driven by the nature of the country's semi-presidential system.

Figure 6.1: Industrial Parks in Romania

Figure 6.1 depicts the distribution of IPs in Romania as of 2010, where the bold-faced numbers indicate the number of IPs in a particular district. Though the initial IP legislation had been on the books for eight years al-

ready, the 52 IPs developed cover only 2500 hectares of land. Poland, features SEZs that cover 16200 hectares, which is more than six times greater than that of Romania. Of the IPs currently in existence, the Eurobusiness Park in Oradea is among the most successful. The Oradea IP began operation in 2008 and features industrial processing facilities, finance and banking companies, consulting, design, R & D, logistics, and other companies. The main investors in the Oradea IP are from the United States and South Korea, with an estimated 30 million Euro invested, having created close to 1500 jobs (Dodescu and Chirila 2012).

Despite such successes, the IPs overall have been less effective in attracting jobs to economically depressed areas. According to Popescu and Ungureanu (2008), Romanian IPs simply cannot compete with similar incentive structures in Poland, Hungary, or the Czech Republic, in large part due to the fact that markets are more developed and project results are expected to be of higher quality in these countries. Additionally, Romanian efforts regarding industrial parks have been greatly delayed compared to those of neighboring countries.

6.8 Legislative cohesion

According to my theory of the politics of FDI incentives provision, I expected that labor in Romania supports FDI and FDI incentives, while domestic business opposes FDI and FDI incentives. I also expected Roma-

nia's presidential regime, which features lower levels of legislative cohesion, to have supported lower levels of FDI incentives. Based on the evidence provided above, I find partial support for my theoretical expectations. First, it appears that the Romanian public has mixed views towards FDI and FDI incentives. For instance, some unions have publicly supported foreign investment, while others have publicly opposed foreign investment. However, I find significant support for my contention regarding opposition to foreign investment on the part of domestic capital in Romania. In large part due to the country's incomplete transition from communism, former members of communist elite, the nomenklatura, have remained singularly powerful. Many of these individuals used their political power to gain significant footholds in the postcommunist economy. The business interests of the former nomenklatura have been or remain tied to former or currently state-owned assets, which would have little chance of success under conditions of global competition. As a result, Romania's domestic business class has largely opposed foreign investment.

Finally, I present evidence that Romania's semi-presidential executive regime has featured significant conflicts over economic reforms and other issues between president and parliament. I suggest that low levels of legislative cohesion in Romania's executive have negatively impacted the country's provision of FDI incentives, one example of which is the country's relatively low level of industrial parks.

6.9 Conclusion

In this chapter, I have provided an examination of the mechanisms of my theory of the politics of FDI incentives provision by contrasting a case of low legislative cohesion with the case of high legislative cohesion described in Chapter 5. As compared to Poland's parliamentary system, Romania's semi-presidential system features lower levels of legislative cohesion. This is best evidenced by severe conflict between president and prime minister in a number of instances. Compared to evidence in Chapter 5 supporting my theoretical expectation that labor supports FDI, the evidence for Romania in Chapter 6 is less robust. However, I do find strong evidence in both cases in support of my contention about the negative attitudes of domestic business towards FDI policy. In the main analysis of the chapter, I discussed how low legislative cohesion adversely affected the development of industrial parks in Romania. By contrast, I discuss in Chapter 5 how legislative cohesion has served to assist the growth of the analogous special economic zones in Poland. In sum, I find tentative support for my theoretical predictions

Chapter 7 extends my analysis of the politics of FDI incentives in a different direction. Whereas previous empirical chapters have been direct examinations of my theory of FDI incentives, I use original survey data from Poland to draw conclusions about the determinants of individual-level attitudes towards FDI incentives.

Chapter 7

Preferences towards FDI incentives: survey evidence

7.1 Introduction

In Chapters 5 and 6, I rely on qualitative evidence to examine the mechanisms of my theory of the politics of FDI incentives provision. The main premise of Chapter 5 is that because Poland has a parliamentary executive regime, the country would feature more generous FDI incentives. By contrast, I expected Romania, the concern of Chapter 6, to have lower levels of FDI incentives because of its presidential executive regime. While my expectations with respect to the relationships between executive regime type and FDI incentives were upheld, the evidence was mixed regarding the preferences of labor and domestic business with respect to FDI and FDI incentives

provision.

In order to examine these findings a little more closely, I shift gears to focus on individual-level attitudes towards FDI incentives. In this chapter, I analyze the preferences of labor and capital towards FDI incentives using the results of a unique public opinion survey conducted Poland in November 2015.[1] As asserted previously, I expect labor to support FDI and FDI incentives because FDI raises labor demand. Local business owners, by contrast, oppose FDI and FDI incentives because the higher demand for labor associated with FDI inflows drives up production costs and cuts into income.

The rest of the chapter is organized as follows. I next provide a short literature review of recent political economy studies that employ survey evidence. I then describe the data analyzed in this chapter, with full descriptive statistics provided in the chapter's appendix. Before proceeding to the central analytical portion of the chapter, I use confirmatory factor analysis to examine the three survey questions which I designed to address attitudes towards FDI incentives. Based on the results from the confirmatory factor analysis, I then use ordinal probit models to explore the attitudes of labor and capital towards FDI incentives. I conduct robustness checks and then summarize the ground covered in the chapter in a concluding section.

[1]This survey received approval from the University of Minnesota Institutional Review Board, study #1409E53862. The survey was made possible by generous support from the Alexander Dubcek Fund and the Andrew Dickinson Fellowship.

7.2 Literature review

A number of studies in both international and comparative political economy make use of public opinion data in order to examine individual preferences over economic policy. Much of this work finds significant support for the contention that policy attitudes are affected by distributional concerns. Using data from a survey of 2500 Canadians in 1988, Balistreri (1997) shows that distributional considerations appear to be important determinants of an individual's preferences over trade policy. In addition, Scheve and Slaughter (2001) find that factor type dominates industry of employment in explaining support for trade barriers, based on analysis of 1736 individual level observations from the 1992 National Election Studies dataset.

Baker (2005) adds texture to the distributional consequences of trade approach, noting that consumer tastes also play role. In analyzing 53,000 observations from 41 countries between 1995-1997 from the World Values Survey, Baker notes that individuals who prefer their country's exportable goods are more protectionist than individuals who prefer imports. Though 14 post-socialist cases are included in Baker's analysis, the cases are not analyzed separately from the rest of the world. While providing support for the factor endowments approach, Mayda and Rodrik (2005) find that trade preferences are correlated with trade exposure to the sector in which an individual works, an individual's relative economic status, and an individual's values, identities, and attachments. Mayda and Rodrik use 20,000 obser-

vations covering 23 countries from the International Social Survey Program from 1995 as well as the data used in Baker (2005). Mayda and Rodrik include 8 post-socialist cases in the analysis, but also do not provide a separate analysis.

Political economy research, however, has only recently begun to use public opinion data to explore individual preferences regarding FDI and FDI incentives. Of existing work, Pandya (2010) is the most prominent. In this study, Pandya finds support for factor-based preferences for FDI, using 37,000 observations from the Latinobarometer Survey from 1995, 1998, and 2001. There are two major reasons why the survey analysis in this chapter is a worthwhile contribution to the existing body of literature. First, political economy studies of public opinion and FDI have yet to focus on post-socialist countries alone. Second, no existing studies have explored individual-level determinants of preferences over FDI incentives. As such, the analysis I conduct in this chapter is an important step in examining theoretical predictions about individual attitudes towards FDI incentives.

7.3 Data

The data I use in this chapter are drawn from an original survey conducted in November 2014 in Poland by the Public Opinion Research Center (CBOS), a respected Polish survey company. After I constructed a series of questions aimed at uncovering attitudes towards my outcomes of interest,

I worked with CBOS to develop appropriate translations of the questions. Once this process was complete, the questions were included in CBOS's November 2014 omnibus survey. Summary statistics for all variables are provided in the appendix.

With respect to the dependent variable, the survey data provides three candidate questions that probe respondent attitudes towards FDI incentives. The first question asks: "*Do you strongly agree, agree, disagree, or strongly disagree with the statement: the government should provide incentives to attract foreign direct investment?*" This question is represented by the variable *providefdiinc*, which is equal to 1 if the respondent replied strongly disagree, equal to 2 if the respondent replied disagree, equal to 3 if the respondent replied agree, and equal to 4 if the respondent replied strongly agree. The second question asks: "*Do you strongly agree, agree, disagree, or strongly disagree with the statement: Poland's government consistently supports incentives to attract foreign direct investment because members of the government coalition are afraid of losing power?*" This question is represented by the variable *fdisupport*, which is equal to 1 if the respondent replied strongly disagree, equal to 2 if the respondent replied disagree, equal to 3 if the respondent replied agree, and equal to 4 if the respondent replied strongly agree. The third question asks "*How beneficial to the economy are government incentives to attract foreign direct investment?*" This question is represented by the variable *fdiincgood*. The variable equals 1 if the respondent replied strongly harmful, 2 if the respondent replied harmful, 3 if the respondent

replied beneficial, and 4 if the respondent replied very beneficial. I provide descriptive statistics for each of the three dependent variables below.

Figure 7.1: Univariate Distribution of *providefdiinc*

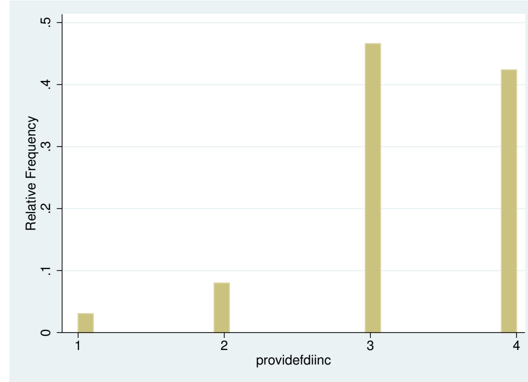


Figure 7.2: Univariate Distribution of *fdisupport*

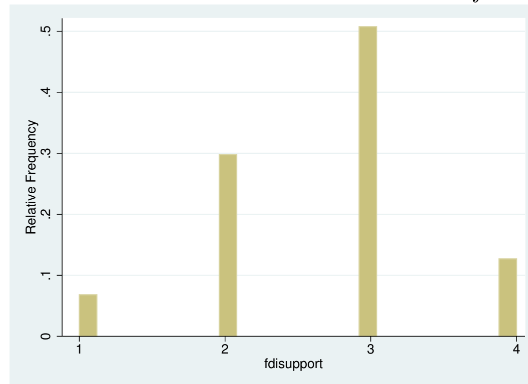
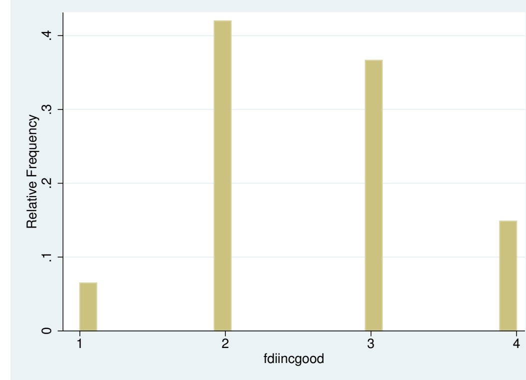


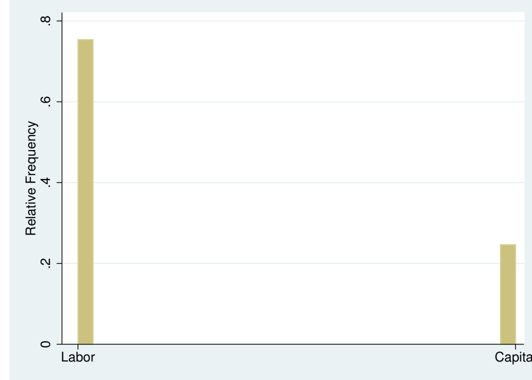
Figure 7.3: Univariate Distribution of *fdiincgood*



The independent variable, *Income*, was constructed based on survey responses to a question about monthly household incomes.[2] Of the five possible responses, I isolated the top category and combined the bottom four categories. The intuition is that owners of capital are the high income members of society and are relatively few in number. By contrast, labor is more numerous and has lower income. In the analysis, 0 represents labor and 1 represents capital for the *Income* variable. I provide a histogram of this variable below.

[2]Capital ownership would have been a more appropriate measure here, but this information was not available. While the income level variable may not match exactly on to capital ownership, income is the best available measure from the survey.

Figure 7.4: Univariate Distribution of *Income*



I also include two additional variables, which have attracted considerable attention in the literature. The first is nationalism. Previous work examining the connection between national pride and attitudes towards economic policy have found that increasing levels of nationalism are associated with protectionist preferences (Mayda and Rodrik 2005; O'Rourke and Sinnot 2006; and Jakobsen and Jakobsen 2011). The variable *Nationalism* represents the following question "*Do you strongly agree, agree, disagree, or strongly disagree with the statement: Poland should follow its own interests?*" The variable equals 1 if the respondent replied strongly disagree, 2 if the respondent replied disagree, 3 if the respondent replied agree, and 4 if the respondent replied strongly agree.

Considerable scholarship examining the determinants of economic policy preferences has explored the role of skill level. Using data from the 1992 and 1996 NES rounds and the 1995 ISSP iteration, Hiscox and Hainmueller (2006) provide support for the contention that individuals with higher edu-

cation have the greater economic literacy necessary to appreciate the welfare gains of free trade, independent of individual income effects. As regards attitudes towards MNCs, Kaya and Walker (2012) use data from the 2003 ISSP to find that highly-skilled individuals are less likely to see MNCs as damaging to local businesses.

Using original survey data from China, Zhu (2011) concludes that support for FDI depends on an individual's skill level as well as the level of skill required by a particular FDI project. Pandya (2010) shows that support for FDI inflows increases with a respondent's skill level. In particular, Pandya demonstrates that respondents with a university education are between 7-10% more likely to support FDI inflows. Following this approach, I proxy for skill level with an ordinal variable of respondent self-reported educational levels. The variable *Skill level* equals 1 if a respondent reports no schooling; 2 if elementary school; 3 if high school or vocational school or some university; and 4 if a university degree or higher.

I also provide controls for gender, age, city size and region. Burgoon and Hiscox (2008) use 2003 survey data from the United States to suggest that women are far more likely to be protectionist than men with respect to economic policy. The authors posit that this gender gap is due to differences in exposure to economic ideas and information. The variable *Gender* equals 0 if the respondent is a man and equals 1 if the respondent is a woman. Age is predicted to be positively associated with support for protection, following Mayda and Rodrik (2001) and O'Rourke and Sinnott (2001). The variable

Age is an ordinal variable which equals 1 if the respondent's age is 18-24; 2 if 25-34; 3 if 35-44; 4 if 45-54; 5 if 55-64; and 6 if 65 and up. City size is predicted to be negatively related to free trade because protectionism may be associated with industrial sectors, which are located in more urban areas (Baker 2003). The variable *City size* equals 1 if the population of the respondent's town is rural; 2 if urban up to 19,999; 3 if urban from 20,000 to 49,999; 4 if urban from 50,000 to 99,999; 5 if urban from 100,000 to 499,999; and 6 if 500,000 and above. Finally, the *Region* dummy variable is included to control for locational or geographic characteristics that may affect attitudes towards FDI incentives. I organize Poland's 16 wojewodstwa (provinces) into 5 geographical regions, with northern provinces as the omitted category.

7.4 Confirmatory factor analysis

The first step I take is to assess the latent variable, or factor, that I hypothesize as accounting for commonality among the three survey questions pertaining to FDI incentives in the CBOS 2014 survey results. A factor is an unobservable variable that influences more than one observed measure and which accounts for correlations among these observed measures (Brown and Moore 2012). I use confirmatory factor analysis (CFA) to explore the hypothesis that the three survey questions are related to the latent factor, which I define as *FDI Incentives Attitudes*. CFA is a special case of structural equation modeling (SEM), corresponding to the measurement model of SEM

that links a set of observed variables to a smaller set of latent variables. My goal in using CFA here is to generate a more accurate measure of attitudes towards FDI incentives by potentially combining two or three of the survey measures. In combining the measures, I limit the effects of measurement bias, which adds to the validity of the outcome covariate.

Figure 7.5: Path Diagram

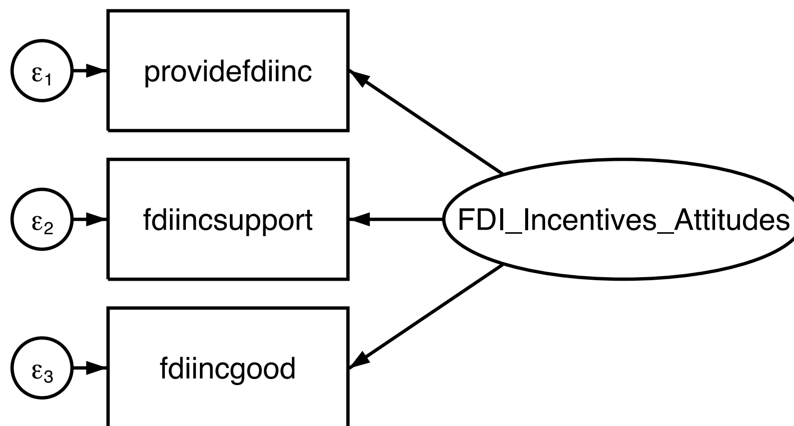


Figure 7.5 shows the hypothesized relationship between the latent factor, *FDI Incentives Attitudes*, and the three observed measures. Errors are represented by the three ϵ terms. The arrows running from the latent factor to the three observed measures represent factor loadings. According to Joreskog (1971), a factor loading is defined as the relationship between a factor and an observed measure. Another way to understand factor loadings in CFA is as the correlations between the observed measures, given the

latent construct. Higher factor loadings suggest stronger relationships between observed measures. If the latent construct were to be partialled out, the intercorrelations among the observed measures would be zero.

Table 7.1: Confirmatory Factor Analysis: FDI Incentives Attitudes

Variable	**Loading**	**Uniqueness**
providefdiinc	-0.811	0.342
fdiincsupport	0.419	0.825
fdiincgood	0.665	0.557
N	534	
CFI	0.730	
χ^2	46.25	
Prob > χ^2	0.000	

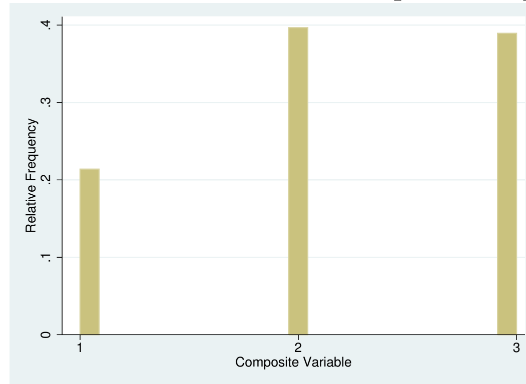
CFA results are depicted in Table 7.1, which provides factor loadings, uniqueness statistics, and two goodness of fit statistics, the comparative fit index (CFI) and the χ^2 score. Compared to the number of observations for each individual measures of attitudes towards FDI incentives, the number of observations for the CFA analysis is significantly lower. This is because respondents did not answer all three questions. Loading for the *providefdiinc* variable is strongly negative. Loadings for *fdiincsupport* and *fdiincgood* suggest reasonably strong positive relationships for these variables. Uniqueness, according to Niemi, Craig, and Mattei (1991), is the percentage of variance that is not explained by the common factors. As such, high uniqueness scores may suggest that a particular factor model may not be particularly useful.

The relatively high uniqueness scores for *fdiincsupport* and *fdiincgood* may support such a conclusion. The χ^2 score, as it were, also raises questions about the appropriateness of the factor model presented. For CFA, significant χ^2 scores suggest poor model fit. However, Joreskog (1971) points out that the χ^2 test may be somewhat problematic. As such, the CFI score may help to moderate these concerns as CFI scores closer to 0.95 are seen as more positive assessments of model fit.

Despite the above concerns, I move forward with building a composite measure of attitudes towards FDI incentives. By creating this composite dependent variable, I attempt to limit the impact of measurement bias that may be associated with each individual variable. I choose the *fdiincsupport* and *fdiincgood* variables because they have positive factor loadings, suggesting a positive relationship with the latent factor, *FDI Incentives Attitudes.* I create the composite variable by adding *fdiincsupport* and *fdiincgood* together, which yields a preliminary variable comprising seven categories ranging from 2 to 8. I assume that scores of 2, 3, and 4 correspond to cases in which the respondent either strongly disagreed (an original score of 1) or disagreed (an original score of 2) with the survey question. As a result, I transform these scores into scores of 1, which indicate that a respondent disagrees. Similarly, I assume that scores of 6, 7, and 8 correspond to cases in which the respondent either agrees (an original score of 3) or strongly agrees (a original score of 4). I assign these cases scores of 3. Because scores of 5 on the preliminary composite variable are combinations of 2 (disagree) and 3 (agree), I assume

that these scores comprise a middle category of 2. In sum, the composite variable consists of three categories: 1 (disagree), 2 (disagree/agree), and 3 (agree). A histogram of this variable is depicted below.

Figure 7.6: Univariate Distribution of Composite Dependent Variable



Before moving to the main empirical analysis of the chapter, I first provide a cross tabulation of the composite dependent and income variables. As Table 7.2 indicates, labor is increasingly supportive of FDI incentives. Support for FDI incentives by capital initially rises, but then decreases.

Table 7.2: Composite DV and Income

Response	Labor	Capital	Total
Disagree	77	40	117
Agree/Disagree	153	64	217
Agree	165	48	213
Total	395	152	547

7.5 Ordinal analysis

7.5.1 Empirical strategy

As suggested above, attitudes towards FDI incentives are arrayed upon a latent and unobservable continuum. However, the composite variable I construct from the two observed survey variables is observable and has four distinct categories. The latent model is specified below:

$$y_i^* = \beta_0 + \beta_1 Income + \beta_k Control_i + \epsilon_i \qquad (7.1)$$

where y^* is the continuous latent variable, the βs are unknown parameters for independent variables and various control variables, while ϵ_i is the error term. β_1 provides my measure of the distinction between labor and capital, based on self-reported income levels. As per my theoretical expectations, I predict a negative association between income and attitudes towards FDI incentives. Instead of y_i^*, I observe the composite *FDI Incentives Attitudes* variable y_i, which is rank ordered and limited in terms of the number of categories. I therefore use ordered probit to estimate the effects of the explanatory variable, *Income*. Because hypotheses are directional, I use a one-tailed test.

7.5.2 Results

In Table 7.3, I present the results of the ordinal probit analysis. Model 1 includes only the income variable and three controls, while Model 2 adds the

nationalism variable and Model 3 includes both nationalism and skill level variables.[3]

Table 7.3: Attitudes towards FDI Incentives, Composite Dependent Variable

Variable	**Model 1**	**Model 2**	**Model 3**
Income	-0.209*	-0.219***	-.166
	(0.111)	(0.115)	(0.108)
Gender	0.092	0.096	0.104
	(0.097)	(0.1)	(0.101)
Age	0.099***	0.092***	0.07**
	(0.029)	(0.031)	(0.032)
City Size	-0.057**	-0.052**	-0.032
	(0.176)	(0.029	(0.031)
Nationalism	-	0.119**	0.116**
		(0.058)	(0.059)
Skill level	-	-	-0.238***
			(0.086)
N	547	516	516
AIC	1159.705	1096.58	1090.872

(Std. errors in parentheses; Dummy variables excluded)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

[3] I do not report results for region dummy covariates, as these were not statistically significant across the models.

As Table 7.3 shows, I find significant results for Models 1 and 2. The effect of *Income* is statistically significant and negative in Models 1 and 2, as expected. However, the inclusion of the *Skill level* variable in Model 3 appears to affect the significance of *Income*. *Age* is significant and positive across all three models, which suggests that attitudes towards FDI incentives grow more positive as respondents become older. *City size* is significant and negative, which lines up with the predicted result. Puzzlingly, *Nationalism* is significant and positive in Models 2 and 3, which suggests that stronger nationalist sentiments are associated with more favorable attitudes towards FDI incentives. The result in Model 3 that *Skill level* is significant and negatively associated with attitudes towards FDI incentives is also rather puzzling. I provide AIC scores, which give an assessment of relative model fit. Based on these metrics, Models 2 and 3 provide better fits to the data as compared to Model 1.

7.5.3 Model robustness

Given the somewhat uncertain results from the confirmatory factor analysis above, I conduct two robustness checks. The first replaces the composite outcome variable with the *fdiincgood* variable. Table 7.4 presents the results of this robustness check. The second approach reconstructs the composite variable by multiplying *fdiincgood* and *fdiincsupport* together to create a continuous variable. I use OLS to conduct this analysis and report the results

in Table 7.4.[4]

Table 7.4: Attitudes towards FDI Incentives, fdiincgood variable

Variable	**Model 1**	**Model 2**	**Model 3**
Income	-0.203**	-0.233**	-0.222**
	(0.096)	(0.099)	(0.102)
Gender	0.076	0.081	0.083
	(0.082)	(0.087)	(0.087)
Age	0.091***	0.096***	0.013**
	(0.025)	(0.027)	(0.028)
City Size	0.04*	0.044*	0.049*
	(0.024)	(0.025)	(0.026)
Nationalism	-	-0.07	-0.073
		(0.151)	(0.05)
Skill level	-	-	-0.052
			(0.075)
N	693	635	635
AIC	1651.846	1523.012	1524.524

(Std. errors in parentheses; Dummy variables excluded)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

[4] As before, I do not report results for region dummy covariates, as these were not significant across any of the models.

Table 7.5: Attitudes towards FDI Incentives, Composite Variable Alternative Approach

Variable	**Model 1**	**Model 2**	**Model 3**
Income	-0.644**	-0.662**	-0.539*
	(0.096)	(0.316)	(0.322)
Gender	0.288	0.309	0.335
	(0.082)	(0.274)	(0.274)
Age	0.267***	0.237***	0.208**
	(0.081)	(0.086)	(0.087)
City Size	-0.04	-0.022	0.02
	(0.024)	(0.080	(0.084)
Nationalism	-	0.366**	0.366**
		(0.022)	(0.159)
Skill level	-	-	-0.085*
			(0.075)
N	547	516	516
AIC	2795.039	2635.351	2680.839

(Std. errors in parentheses; Dummy variables excluded)
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < .10$

Using this alternative dependent variable, I find significant results for *Income* across all models. In Table 7.4, the effect of *Income* on the *fdiincgood* variable is statistically significant and negative, as expected. *Age* remains significant and positive, while *City Size* is now positive and significant. *Nationalism* and *Skill level* are not found to be significant in this robustness check. Similar to the pattern above, AIC scores suggest that Models 2 and 3 are fits for the data. Based on AIC scores, all three models provide better fits to the data than the three models in the original analysis. Table 7.5 also shows that *Income* has a negative effect on attitudes towards FDI incentives, as represented here by the alternative composite variable. As in the original analysis, *Age* and *Nationalism* remain positive, while *Skill level* is negative.

7.6 Conclusion

In this chapter, I examine the attitudes of labor and capital towards FDI incentives by conducting empirical analysis on a unique public opinion survey from Poland. My theoretical expectations that labor seeks FDI incentives and capital opposes them are supported by two of three models in the main analysis and all six models in robustness checks. Although the data used in this chapter are from Poland alone, they are perhaps suggestive of attitudes towards FDI incentives in other countries in Central and Eastern Europe that have recently acceded to the European Union, have similar per capita incomes, and levels of democracy. In order to generalize further

about attitudes towards FDI incentives around the world, additional survey research is needed.

This study of attitudes towards FDI incentives helps to build the foundation for a broader theory of FDI demand. As Pandya (2010) notes, preferences underlie more aggregate phenomenon such as decisions about international investment cooperation, issues regarding national FDI regulation and lobbying for FDI policies. Given that little is known about these aspects of the political economy of FDI, additional understanding is welcome.

7.7 Appendix

Table 7.6: Descriptive Statistics

Variable	Unit	Obs	Mean	Std. Dev.	Min	Max
Composite DV	Index	547	2.176	0.757	1	3
Alt. Composite DV	Index	547	6.963	3.117	1	16
providefdiinc	Index	852	3.282	0.739	1	4
fdiincsupport	Index	662	2.693	0.777	1	4
fdiincgood	Index	693	2.599	0.818	1	4
Income	Binary	934	0.246	0.431	0	1
Gender	Binary	934	0.55	0.498	0	1
Age	Index	934	3.845	1.654	1	6
City Size	Index	934	2.734	1.817	1	6
Region	Dummy	934	3.484	1,361	1	5
Nationalism	Index	817	2.659	0.867	1	4
Skill level	Index	934	3.052	0.66	1	4

Chapter 8

Conclusions

8.1 Introduction

Existing approaches to the study of the politics of foreign direct investment incentives are adversely affected by an important oversight: consideration of certain aspects of domestic politics. In order to address this issue, I develop an argument that explains why some democracies offer generous incentives to attract FDI, while other democracies do not. First, I suggest that FDI inflows have distributional consequences, drawing on the specific factors model of international trade. This approach suggests that labor benefits and domestic capital is harmed from FDI inflows. A major implication of this is that labor supports FDI inflows and FDI incentives, while domestic capital opposes FDI inflows and FDI incentives. However, these preferences for FDI incentives are moderated by a key political institution, executive regime type.

I argue that higher levels of legislative cohesion in parliamentary regimes lead to higher levels of FDI incentives offered. By contrast, separation of powers in presidential regimes leads to lower levels of FDI incentives provided.

In this concluding chapter, I recap the theoretical and empirical ground covered in my dissertation. I note the literature in which I situate my theory of the politics of foreign direct investment incentives, then I summarize the theory. Next, I describe the game theoretic approach I use to characterize the testable hypotheses I examine in the empirical chapters. I summarize the findings of the cross-national statistical chapter, the case studies of Poland and Romania, and the survey analysis chapter. Finally, I provide a few caveats and potential extensions of my dissertation.

8.2 The politics of foreign direct investment incentives

FDI incentives and bureaucratic support for foreign investors factor into decisions by multi-national corporations (MNCs) to invest abroad. According to Li and Resnick (2003), investment incentives represent a transfer of benefits from domestic taxpayers to foreign investors. Incentives to attract foreign investors can be seen as direct government intervention in capital markets, which affects the allocation of scarce financial resources, influences government revenues, and favors particular groups at the expense of others (Antaloczy, Sass, and Szanyi 2011). The literature puts forward two main

explanations for the politics of FDI incentives. First, proponents of the convergence thesis suggest that governments have increasingly chosen to adopt incentive programs under conditions of intensifying competition among national governments for limited investment capital (Guisinger 1985; Stopford and Strange 1991; Thomas 2000). Under conditions of increasing capital mobility and financial integration, governments have to compete with one another to keep existing capital and attract additional mobile factors of production, such as foreign capital. In order to attract FDI, a government might intensify use of a policy instrument that increases the rate of return to foreign investment, such as corporate tax exemptions, deployment of investment promotion agency resources, or direct subsidies to companies. However, these policy changes create negative externalities for other states competing for a mobile factor such as foreign investment. Thomas (2000) suggests that this situation resembles a n-person "Prisoner's Dilemma" in which every government has a dominant strategy of seeking to make its market more attractive than its neighbors' markets. The suboptimal equilibrium outcome to this game is that all countries and their citizens are worse off due to the costs of providing tax exemptions, funding investment promotion agencies, or paying subsidies, while the mobile factor may remain distributed as before. On the other hand, the owners of the mobile factor of production reap increased rewards in the guise of greater FDI incentives.

The second main explanation focuses on the effect of democratic or autocratic political institutions on a country's provision of FDI incentives. Tax

incentives may affect investment via the "illusory compensating effect" (Shah and Toye 1978). In other words, generous FDI incentives might be an attractive way to compensate for the absence of proper infrastructure, outdated technology, and a paucity of natural resources. Additionally, countries with low policy credibility are not attractive hosts for FDI and so governments in these countries may offer incentives to make up for the credibility gap (Janeba 2002). As such, host countries with better economic and political locational conditions provide a better investment environment and therefore higher returns. In order for host countries with more benign locational characteristics to successfully attract FDI, governments need not offer the same levels of incentives as countries with worse locational conditions. Weak property rights protection and low policy credibility are predicted to be associated with generous incentives to attract FDI.

Li (2006) argues that democracies and autocracies offer different levels of FDI incentives because of differences with regard to property rights protection and policy credibility. A constrained executive, an independent judiciary, and an open civil society, which are the features of democratic political systems, support the rule of law and defense of property rights. By limiting the power of politicians, democratic political institutions permit greater representation and raise the costs of providing private benefits. This makes a state's commitment to the rule of law more credible (North and Weingast 1989). For Li (2006), strong property rights protection and policy credibility in democracies lead to lower levels of FDI incentives provided, as

compared to autocracies. Investors expect governments in these countries to uphold bargains, therefore democratic governments offer fewer incentives to foreign investors (Simmons 2000).

8.3 Gaps in the literature and theoretical approach

The politics of FDI incentives literature ignores important dimensions of domestic politics, particularly the domestic distributional consequences of capital flows and the policy implications associated with executive regime types. The theoretical predictions I formulate are intended to bring domestic politics into sharper focus in this literature. My understanding of the distributional consequences of FDI inflows relies on the specific factors model of international trade. In an economy with three factors and two industries, I assume that labor is mobile across industries while capital is immobile and fixed to each of the two industries. After FDI has entered one of the two industries, this has the effect of increasing the supply of productive capital in that industry. Given a certain technology that determines the ability of the foreign investor to complement either factor of production, an inflow of FDI affects the returns to labor and capital in the host country across industries. FDI inflows compete wages up and push rents down by increasing demand for labor across the economy. The key result is that labor prefers that the government offer higher levels of FDI incentives, while domestic cap-

ital prefers few or no incentives to attract FDI (Pandya 2010 and 2014; Pinto 2013). Though FDI incentives are not direct transfers to labor, these forms of government spending can be considered resource allocations designed to favor one constituency, labor, over another constituency, domestic capital. It follows that those harmed by FDI would be opposed to FDI incentives, while those benefitting from FDI inflows would be supportive of FDI incentives.

The preferences of labor and capital for FDI incentives, however, are moderated by a country's executive regime type. Persson et al. (1997, 1998b, 2000) and Persson and Tabellini (2005) develop a sophisticated explanation for differences between presidential and parliamentary regimes. Presidential regimes are characterized by separation of powers between legislative and executive authority, which means that more institutional actors must be satisfied in order for policy changes to be enacted. An important feature of the presidential system is the prevalence of unstable political coalitions. This means that the beneficiaries of FDI incentives have to "sell" the FDI incentives policy to the institutional actors. This drives down the level of FDI incentives because some institutional actors prefer lower levels of incentives as compared to others. The beneficiaries of FDI incentives, however, will accept whatever level of incentives is offered. The implication is that presidential systems offer lower levels of FDI incentives.

Building on the work of Diermeier and Feddersen (1996), Persson et al. (2000) use the idea of legislative cohesion to characterize parliamentary regimes. Legislative cohesion refers to disciplined voting by members of

a governing coalition. Parliamentary regimes feature large governing coalitions, which necessarily are more broadly representative. As labor constitutes a greater number of individuals in society, parliamentary coalitions are more representative of labor than of capital. The parliamentary coalition chooses to offer a higher level of FDI incentives in order to maximize labor's support within the larger bloc of voters which needs to be satisfied to maintain coalition stability and keep politicians in office.

In Chapter 3, I provide a formal derivation of the logic underpinning my theory of the politics of FDI incentives provision. I first assume that both parliamentary and presidential regimes lie on a legislative cohesion continuum, where parliamentary regimes feature high levels of legislative cohesion and presidential regimes have low levels of legislative cohesion. This assumption greatly assists in the empirical analysis conducted in Chapters 4, 5, and 6.

My game theoretic approach draws on Baron and Ferejohn's (1989) model of policy choice in small groups, or "legislative bargaining." Baron and Ferejohn, in turn, build upon Rubinstein's (1982) model of two-player bargaining. In the two models presented, I assume that bargaining takes place over the distribution of a shared tax base. In the presidential regime, bargaining happens within the legislature and between the legislature and executive. In the parliamentary context, bargaining occurs only within the legislature. As each legislator represents only her individual district, which bears only part of the cost of spending on FDI incentives but all of the

benefits, each legislator has incentive to overspend. On the other hand, the executive represents the entire country, meaning that her district bears the full cost of spending on FDI incentives as well as the full benefit. This implies that the executive lacks the same incentive to overspend as the individual legislator. Bargaining occurs in a simple one-period legislative "ultimatum game," in which the agenda setter makes a take-it or leave-it offer to the other actors.

Using these tools, I derive a testable hypothesis of my main theoretical prediction, that democratic governments with higher levels of legislative cohesion offer higher levels of FDI incentives. I also derive a secondary hypothesis, which suggests that the interaction between legislative cohesion and FDI inflows has a negative effect on levels of FDI incentives provided in democratic parliamentary and presidential regimes.

8.4 Evidence: cross-national analysis

In order to test the hypotheses presented, I first conduct cross-national empirical analysis of an original dataset. I constructed this dataset by collecting 1400 "Investment Climate Statements" from 2005-2014 from the U.S. Commercial Service. I used the R software program to implement webscraping techniques for collecting and preprocessing the documents (Feinerer et al. 2008), then hand coded 140 of the documents for FDI incentives as per Li (2006), with one addition. Once manual coding had been completed, I used

R to run four training algorithms, which classified uncoded documents as per the manually coded documents. After running all four algorithms, I noticed that two, support vector machines (SVM) and random forests (Forests), coded the country documents much less consistently than the other two, Logitboost and generalized linear models (GLM). In order to address this lack of consistency, I re-ran the training algorithms with only Logitboost and GLM, which provided more consistent results. I then combined my original FDI incentives dataset with data from the Quality of Government database.

I ran two sets of analyses. The first used pooled ordinal probit models, the results of which provide mixed support for my contention that governments with higher levels of legislative cohesion are associated with higher levels of FDI incentives provided. However, the pooled ordinal model results support my second hypothesis, that as moderated by the level of FDI inflows, the effect of legislative cohesion on FDI incentives provided is negative.

However, as the dataset I use can be described as an unbalanced panel, there are two issues that the pooled ordinal model specification does not address. For one, the pooled ordinal model does not account for country-level heterogeneity. In other words, there may be omitted variables that impact why countries differ with regard to levels of FDI incentives. As my theory assumes that differences between countries do have an impact on the level of FDI incentives offered, it may be important to account for this heterogeneity. Second, the pooled ordinal model does not address the effect of time on the levels of FDI incentives offered.

In order to address these issues, I specify a different model, an ordinal probit model with region and time fixed effects. Using the fixed effects model, I find the relationship between legislative cohesion and the level of FDI incentives provided to be statistically significant and positive, as suggested in Hypothesis 1. I also find support for Hypothesis 2 that, as moderated by the level of FDI inflows, the effect of legislative cohesion on FDI incentives provided is negative.

8.5 Evidence: case studies

In an effort to examine the mechanisms of my theory, I examined two case studies. Building off of descriptive statistics of the post-socialist cases compared to other countries in Chapter 4, I explore two post-socialist case studies in Chapter 5 and 6. The post-socialist countries are unique for a number of reasons. First, these countries embarked on complex political and market transitions at roughly the same time. The post-socialist countries also started the transition with relatively similar relatively similar economic conditions, due to the shared legacy of the socialist planned economy. Second, the world was beginning to feel the full force of globalization at the initial stages of post-socialist transition, which had significant consequences for these countries. In effect, the post-socialist countries can be treated as a quasi-experimental context in which to examine policy choice.

The two post-socialist cases, Poland and Romania, have transitioned to

market democracy and gained membership to the European Union in 2004 and 2007, respectively. Poland has been a parliamentary democracy since 1997, while Romania has maintained a semi-presidential system since 1989. In each case study, I discuss transitions from communism, briefly note an episode of the politics of FDI policy, examine the preferences of labor and capital as regards FDI and FDI incentives, characterize the nature of the executive regime in each country, and present an operationalization of FDI incentives, in the form of special economic zones (SEZs) in Poland and industrial parks (IPs) in Romania. Both SEZs and IPs are similar policy tools designed to promote economic activity of a particular kind in a designated geographical area, often one that has experienced decline after the implementation of post-communist structural reforms. In Chapter 5, I also discuss aspects of union strength in post-socialist countries, note consequences of union-party links, and characterize explanations of varying strength of union opposition to neoliberal reforms. In each case study, I then draw conclusions about why SEZs have developed quickly as compared to IPs, based on my theoretical expectations.

8.5.1 Poland

A large part of Poland's successful economic and political transition can be traced to the role played by the trade union Solidarity, which facilitated mass political action crucial to the fall of Poland's Communist regime. Poland was unique in the post-communist world for having developed a non-

regime oriented mass following during the Communist period (Jowitt 1992). In the early post-transition years, Solidarity played a major role in government, marshalling popular support for political and economic reforms. Economic reform, in the short-term, would mean increased unemployment and greater social inequalities, the burden of which would fall upon Solidarity's most important constituency, workers. Nevertheless, key Solidarity leaders such as Lech Walesa saw market reforms and the encouragement of foreign investment as leading to new jobs, technology, management, corporate culture, and ethics, all of which would assist Poland's entrance into the global economy.[1] However, scholars have noted an interesting pattern of politicized labor union support for economic reforms, as Solidarity and its main union competitor, the All-Poland Alliance of Trade Unions, have waxed and waned in terms of support for economic reforms. As regards popular attitudes towards FDI and FDI incentives, workers began to see over time that foreign investment improved the competitiveness of Polish firms, which increased support for FDI (Domanski 2004). In addition, empirical studies suggests that FDI has a positive effect on wages in Poland (Faggio 2001; Bedi and Cieslik 2002). With this evidence in mind, I find support for my expectation that labor supports FDI and FDI incentives in Poland.

The emergence of a robust non-Communist elite and a mass social movement in Poland meant that regime insiders would find it more difficult to

[1] Lech Walesa Institute, "Foreign Investors in the last 25 Years," Lech Walesa Institute 2014, Warsaw, Poland

remain in power. Additionally, the pace of reform in the initial postcommunist period ensured former communist insiders would be unable to capture sectors of the economy nor sufficiently retain political power to block change (Roland 2002). As such, there was no business lobby to speak of until Poland's economy gained steam in the late 1990s.[2] Existing Polish business owners, though, did voice opposition to FDI, successfully blocking foreign investment into SEZs (Domanski 2004). Economic nationalism among business owners has grown in recent years as the effects of the global economic crisis have been felt more strongly in Poland. In particular, representatives of the pro-business Platforma Obywatelska, in power since 2007, have made noises about promoting Polish "national champions" while also supporting measures to make foreign takeovers of Polish companies more difficult (Parkiet 2010). As predicted by my theory, I find the above as evidence that Polish domestic business has begun to more forcefully oppose the influence of foreign capital.

While Poland initially had a semi-presidential executive regime, parliamentary democracy was instituted after constitutional changes in 1997 (Orenstein 2010). Under the 1992 interim constitution, the Polish president had power to dissolve parliament and exercise discretion over the formation of the cabinet, made up of parliamentarians from the winning coalition and led by the prime minister as formal head of government. The 1997 constitution removed the president's consultative powers as well as the ability to

[2]Author interviews, November 17, 2014, Warsaw, Poland

reject requests by the prime minister for appointing or dismissing ministers. The president also lost the right to chair the cabinet and otherwise influence cabinet decisionmaking as well as veto the budget (Zubek 2011).

SEZs are one tool that the Polish government uses to attract FDI, through preferential tax conditions, such as tax holidays and import duty exemptions, as well as non-tax incentives usually relating to employment and licensing (Gaugliano and Riela 2005). Poland's 14 SEZs have attracted impressive investments from large multi-national corporations, such as Saint-Gobain, Fiat Powertrain Technologies Poland, Dell, Procter and Gamble, Mondi Packaging Paper Swiecie, Sharp, Swedwood Poland, LG Electronics, Shell Polska, and Rockwool Polska (PAIZ Poland, 2014). What is striking about the development of SEZs in Poland is the immense proliferation, currently covering 16,200 hectares in the country.

The Poland case provides tentative support for my theoretical predictions. There are a few reasons why this support is only tentative. First, my theory predicts that Platforma Obywatelska would have been consistently opposed to FDI incentives, such as SEZs, but this was not the case. Second, my theory does not predict that the establishment of SEZs in Poland would have taken place during the existence of the country's semi-presidential system. Conflicts between the president and parliament were particularly intense in 1995, when the SEZs were created. One explanation for the timing of the establishment of the SEZs, however, was the existence of strong consensus across the political spectrum about Poland's interest in attracting foreign

investment in the early post-transition years. At the same time, I describe an episode of deliberations between the Polish legislature and executive over FDI policy, the corporate income tax rate, which helps provide support for my argument.

8.5.2 Romania

According to Gallagher (2005), Romania under Ceausescu possessed more attributes of a totalitarian dictatorship than any other East European party-state. In countries with intense authoritarian experiences, it is implied that the administrative class which prospered under authoritarianism is much less willing to abdicate power. Although mass protests brought down Ceausescu's regime, former Communists swiftly took advantage of the resulting political vacuum (McFaul 2002). There were no pacts, no negotiations, and no compromises during the initial transition. Until 1997, when the ex-communists experienced their first major electoral defeat, there were few meaningful reforms (Ibrahim and Galt 2004). In effect, Romania's authoritarian past facilitated a much less complete break with communism, as compared to Poland.

Opposition control of key political institutions, such as from 1996 and 2000, however, did not result in successful reform efforts in large part due to pushback by entrenched former Communists. Scholars mark the 2004 elections as the end of the post-communist transition and the beginning of determined steps towards democratic consolidation (King and Marian 2013; Downs and Miller 2006; Stan 2005; Gross and Tismaneanu 2004). Romania

stands out as the only democracy in Central Europe where representatives of the Communist successor parties have been participants in nearly every government since the fall of Communism.

Most Romanians in 1989 appeared ready to accept the goal of marketization, but resisted the difficult consequences of reform (Datculescu 1992). Similar to Poland, popular attitudes towards FDI became more positive as FDI inflows increased in the mid-1990s. In addition, empirical evidence suggests that FDI is positively associated with wages in Romania. Although Romanian labor unions did not exhibit the same degree of politicization as their Polish counterparts, unions in Romania have played a role in shaping policy in the post-socialist period. Unions supported and even encouraged market reforms, even as strikes took place against the negative effects of the reforms (Gotia 2011). Despite higher union density than Poland, scholars suggest that recent changes by the Romanian government are significantly weakening union power (Trif 2013).

With regard to business attitudes towards FDI, Vachudova (2005) calls the first seven years of the Romanian transition "a textbook case of the capture of a partially reformed economy by former communist cadres linked closely to the ruling political parties." As such, Romania had a business class at transition, unlike Poland. According to Verdery (2002), Romania's relative economic backwardness obstructed wealth attainment through the market, which led to protectionist views of FDI among elites. The ex-nomenklatura, which dominated the elite, required time to convert their political capital into

economic capital, which translated into suspicious attitudes towards FDI in the early post-transition years (Stoica 2004). Though these attitudes began to break down in the early 2000s, elite attitudes towards FDI and FDI incentives have remained skeptical and opportunistic. It appears that domestic business owners have been properly motivated in their opposition to FDI, as a number of studies have shown that FDI inflows are accompanied by a significant negative competition effect in Romania (Konings 2001; Altomonte and Pennings 2009).

Romania's semi-presidential executive system, modeled roughly after the 1958 French constitution, has engendered serious political conflict since the country's transition from communism. A succession of presidents have sought to expand the power of the presidency, while the parliament and government seek to retain whatever discretion there might be available for them in the constitution. As Tananescu (2008) notes, constitutional ambiguity, combined with strong personalities in the political arena have meant that instability and uncertainty are the key features of Romanian politics.

Similar to SEZs in Poland, Romania has used industrial parks (IPs) to attract foreign investment. In light of Romania's ongoing de-industrialization, policymakers have sought to use IPs in order to attract new jobs to areas affected by the economic restructuring (Popescu 2012). Incentives for businesses include income tax, local real estate tax breaks, and other local government tax incentives, as well as delays in VAT payments for materials and capital equipment installed in the IP. As discussed in Chapter 6, territory and

extent of business is much less than in Poland, amounting to 2500 hectacres.

Overall, the Romanian case provides tentative support for my theory of the politics of FDI incentives provision. My expectations about labor's attitudes in favor of FDI and FDI incentives in Romania are partially supported, while I find stronger evidence in favor of my contention about negative attitudes of Romanian domestic business towards FDI and FDI incentives. A brief discussion of legislative/executive deliberations over economic liberalization, though, provides additional support for the predicted effect of low legislative cohesion leading to lower FDI incentives in Romania's presidential system. Given the rather small size of IPs in Romania compared to the large size of SEZs in Poland, it appears that Romania's semi-presidential system plays a role in limiting the level of FDI incentives provided in the country.

8.6 Evidence: survey analysis

In Chapter 7, I explore the preferences of labor and capital towards FDI incentives by analyzing unique public opinion survey data from Poland. My theoretical expectations that labor supports FDI incentives and capital opposes them are supported by eight of the nine models run in the analysis. While the data used in the survey analysis are from Poland alone, the results are perhaps suggestive of attitudes towards FDI incentives in other countries of Central and Eastern Europe, which have recently joined the European Union, have similar per capita incomes, and levels of democracy. The idea is

that individuals in the post-socialist countries of Central and Eastern Europe, which share a common political and economic legacy and began the transition to market democracy at the same time, may share Polish attitudes towards FDI incentives.

8.7 Caveats, extensions, and final thoughts

8.7.1 Caveats

Though my theory of the politics of FDI incentives provision is an important step towards explaining why some countries offer high levels of FDI incentives, while other countries do not, there are a few caveats worth mentioning. The first concerns the broad outline of my theory. Put simply, I begin with the distributional consequences of FDI, namely that labor benefits from FDI inflows and capital is harmed. I then link the distributional consequences dimension directly to one form of political institutions, executive regime type. I posit here that presidential regimes are associated with lower levels of spending on policies such as FDI incentives, while parliamentary regimes are associated with higher levels of spending on FDI incentives. Next, I assume that government FDI policies have consequences for FDI inflows, which influence the preferences of these groups with respect to FDI incentives.

In effect, my theory covers only two of the steps described above: distributional consequences and the policy implications of executive regime types.

A stronger theory would perhaps fill in a few gaps. First, in moving from distributional consequences to executive regime type policy implications, it could be worthwhile to explore how labor and capital mobilize to articulate preferences over FDI incentives. It is likely that labor and capital address the collective action problem associated with political mobilization in different ways.

Second, the theory could be strengthened by examining the impact of government FDI policy on FDI inflows. Policies may be designed to achieve a particular outcome, but it is not always the case that policy goals are perfectly attained. I argue that when governments spend money on FDI incentives, this increases FDI inflows. The literature, however, maintains some degree of ambiguity on this subject. On one hand, Banga (2003) uses data from south and southeast Asia to show that fiscal incentives have a negligible impact on FDI inflows. Relying on interviews and case studies from South Africa, Tuomi (2011) finds that fiscal incentives did not influence MNC investment decisions. On the other hand, Blomstrom and Kokko (2003) argue that under the right circumstances, FDI incentives have positive effects on the host economy. Cleve (2008) conducts an empirical study of countries in sub-Saharan Africa and finds that certain fiscal incentives, such as tax holidays, are important for attracting FDI inflows.

A useful contribution to addressing ambiguity in the literature about the connection between FDI incentives and inflows would start with building a comprehensive panel dataset that aggregates data on FDI inflows and FDI

incentives, as well as relevant political, economic, and other controls. This approach could help pave the way towards more rigorous and comprehensive macro-level studies of the relationship between the two variables.

Third, additional exploration of the connection between FDI inflows and overall macroeconomic outcomes is worthwhile. I split this contention into two parts. One aspect concerns the effect of FDI inflows on labor and capital. In regards to this dimension, a number of empirical studies suggest strong evidence of a wage premium in foreign-owned firms. Brown, Earle, and Telegdy (2013) use 18 years of data from Hungary to find a 12-28% effect on average wages, across worker types, occupations, and wage quantiles. Lipsey and Sjoholm (2004) analyze data from Indonesia and conclude that wages in locally owned plants were high in industries with a large foreign presence as well as in provinces with a large foreign industrial presence. This is taken to mean that because foreign plants pay higher wages than local plants, foreign presence raises the general wage level in a province and industry. In addition, Figlio and Blonigen (2000) use data from South Carolina to demonstrate that FDI raises local wages. By contrast, empirical work shows that FDI inflows can harm domestic firms by way of increased competition. In a study of firm-level data from Central Europe, Konings (2001) finds evidence of negative spillovers from FDI to domestic firms, due to the competition effect. Aitken and Harrison (1999) use data from Venezuela to show that domestic plants are negatively affected by FDI inflows. Nevertheless, this aspect deserves more systematic study in the future.

The second dimension of the connection between FDI inflows and overall macroeconomic outcomes relates to distinctions between different labor segments with regard to attitudes towards FDI incentives. In other words, do high-skilled workers differ in their support for FDI incentives as compared to low-skilled workers? An empirical study by Driffield and Taylor (2000) uses data from the United Kingdom to suggest that inward FDI substitutes for unskilled labor and complements more skilled labor, because multinationals demand more skilled labor, and domestic firms increase their demand for skilled labor due to technological spillovers. Scheve and Slaughter (2001) find that low-skilled workers are more protectionist than high-skilled workers, based on analysis of results of data from the U.S. Pandya (2010) studies three years of survey data from the Latinobarometer to conclude that preferences over FDI inflows are consistent with FDI's expected effect on individual income. In effect, Pandya finds that high-skilled workers are more supportive of FDI than low-skilled workers. Taken together, the literature suggests that an important cleavage between high- and low-skilled workers exists with regard to attitudes towards FDI incentives. This is certainly a worthy topic of future study.

8.7.2 Extensions

There are at least three potentially fruitful extensions of my dissertation. The first is an empirical approach involving the impact of international agreements on FDI incentives, while the second concerns the distributional

consequences of FDI and FDI incentives. The third considers the relationship between income inequality and demand for FDI incentives.

One extension might examine the relationship between international agreements, such as bilateral investment treaties (BITs) or preferential trade agreements (PTAs), and FDI incentives. By entering into international agreements that commit a country to the liberal economic policies seen as most desirable by foreign investors, a country can create a favorable environment for FDI (Buthe and Milner 2008). Tobin and Busch (2010) add that BITs and PTAs are especially conducive to attracting FDI. The World Bank (2014) reports that 330 PTAs currently active, while UNCTAD (2013) notes that more than 2500 BITs are in effect today. However, Tobin and Ackerman (2011) complicate the story by suggesting that BITs stimulate FDI, but only under specific conditions. First, BITs cannot replace an otherwise weak investment environment, meaning that countries must have some moderately credible domestic political institutions. Second, as the coverage of BITs increases, the marginal effect of a country's BITs on its own FDI might decrease because of competition for FDI from other countries with BITs. As this literature has yet to consider the effect of international agreements on FDI incentives offered, there is ample room for exploration of this relationship.

Second, the case study of Poland in Chapter 5 returned a number of interesting results, one of which was evidence that resistance to FDI in Poland was and can continue to be found in the country's agricultural sector. As noted above, Polish farmers were at the forefront of resistance to plans for re-

structuring the Polish economy (Tridico 2004). In order to modernize Polish agriculture, many farms would need to be eliminated, while rural populations would need to shift to cities and undergo changes in occupation, all of which challenge the traditional rural lifestyle dramatically. Poland's accession to the European Union has already opened the country's economy to market forces and brought some degree of liberalization to the agricultural sector. However, farmers and their political representatives, such as the Polish People's Party (Polskie Stronnictwo Ludowe), have prevented large scale restructuring and foreign investment,[3] mainly through imposition and defense of stringent land-ownership rules (Banski 2004).

Given that agriculture, at least in Poland and likely in many other countries, offers significant resistance to FDI and incentives to attract FDI, theories utilizing the distributional consequences of FDI approach might consider incorporating the agricultural sector. As it stands, the variant of the specific factors model employed in this dissertation postulates three factors and two industries, with capital specific to each industry and labor being mobile between the two industries. To include agriculture, I suggest the following adjustments to the model. First, two factors and two sectors could be added. The two additional factors are landowners and are specific to each of the two new sectors, both of which are agricultural. This brings the number of factors to five and the number of sectors to four. Labor, however, is mobile only between the two capital sectors and between the two new agricultural

[3]Author Interviews November 17, 2014; November 18, 2014; and November 19, 2014

sectors.

Inflows of foreign capital have similar effects on this economy as in the model I employ above. Capital flows to one of the industrial and one of the agricultural sectors raise demand for labor, which increases labor's welfare. Increases in labor's welfare correspond to decreases in the rents available to capital and landowners in the economy. As a result, labor continues to prefer FDI and FDI incentives, while capital and landowners oppose FDI and FDI incentives. Though simple, this adjustment to the specific factors model may stimulate worthwhile explorations into the mechanisms of the distributional consequences approach to the study of the politics of FDI and FDI incentives.

Third, the relationship between income inequality and demand for FDI incentives is worth exploring. If labor market attributes, such as skill level, condition the effect of income inequality on FDI inflows, then it seems likely that labor market institutions play a role in the impact of income inequality on the demand for FDI incentives. Drawing on the varieties of capitalism approach (Hall 2001), countries with coordinated market economies (CMEs) may condition the impact of income inequality on demand for FDI incentives as opposed to liberal market economies (LMEs). CMEs can be characterized as facilitating strategic interaction between firms, government bodies, and other actors as well as a stronger social safety net. As a result demand for FDI incentives remains strong among workers because the potential inequality effects of FDI inflows are softened. By contrast, LMEs feature economic activity coordinate primarily through hierarchies and competitive market

arrangements. The prediction would be that the potential inequality effects of FDI inflows weaken support for FDI incentives in LMEs.

8.7.3 Final thoughts

This dissertation has contributed to the political economy literature by examining the politics behind the provision of FDI incentives in democracies. Building on recent, impressive efforts in the political economy literature, I have used the tools of game theory, quantitative analysis, and case study research to develop, test, probe, and defend my theoretical approach. Future scholarly efforts on the politics of FDI and FDI incentives will undoubtedly broaden our understanding of the workings of the global political economy.

Biography

Aaron Levine Beitman was born in Seattle, Washington on April 13, 1982 and grew up in Columbia, Missouri. He graduated with a B.A. degree in history from Haverford College in 2004 and received an M.S.F.S. degree from Georgetown University in 2009.

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