

Local Politics, Global Capital: Political Alignment and Foreign Direct Investment in Brazil

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April 2024

Factors That Attract FDI (I)

At the country level:

- ▶ Bilateral investment treaties (Elkins et al. 2006)
- ▶ Investor-state dispute settlement clauses (Moehlecke and Wellhausen 2022)
- ▶ Commitment to property rights (Jensen 2003; Li and Resnick 2003)
- ▶ Tax and regulatory policies (Li 2006)
- ▶ Respect to human rights (Blanton and Blanton 2007)
- ▶ Investment incentives (Jensen and Malesky 2018; Klemm and Parys 2012; Oman 2000)

Factors That Attract FDI (II)

At the local level:

- ▶ Low delinquency rates and high education levels (Garriga and Phillips 2022; Escobar Gamboa 2012)
- ▶ Investment attraction offices and overseas investment missions (McMillan 2009)
- ▶ Economic geography (Kandogan 2012; Bobonis and Shatz 2007)
- ▶ Partisanship/ideology of the governor and mayor (Garriga 2022; Arvate and Story 2021; Wang and Heyes 2021; Halvorsen and Jakobsen 2013)

Our Contribution

- ▶ Examine local political factors beyond partisanship/ideology, with a focus on **political alignment**
 - ▶ **Alignment:** the mayor's party is a member of the president's support coalition in Congress

Main Hypothesis

Aligned local governments will attract more FDI than non-aligned ones.

Why?

- ▶ **Mechanism 1:** Aligned mayors have easier access to investment incentives (Sugiyama and Hunter 2013; Ames 2002)
 - ▶ In developing countries, incentives can attract investment (Baccini, Li and Mirkina 2014; Klemm and Parys 2012)
- ▶ **Mechanism 2:** Aligned mayors receive more intergovernmental transfers (Ha and Jenkins 2024; Meireles 2018; Litschig 2012)
 - ▶ These transfers can be used for public goods provision, which in turn attracts investment

Data and Empirics

Case Selection: Brazil

- ▶ The world's second-largest FDI recipient in 2023, after the US
- ▶ A federation with 26 relatively autonomous states, so state/local politics matters
- ▶ A country with strong transparency policies and good data

Dependent Variable: FDI to Brazilian Municipalities

- ▶ Data on all FDI transactions to all Brazilian municipalities, 2011-2021
 - ▶ 51,103 unique transactions
 - ▶ 4,414 out of 5,570 municipalities did not attract a single transaction
 - ▶ Source: Brazilian Trade and Investment Promotion Agency
- ▶ Advantage over other sources: we have data on *actual* (not just *announced*) investment projects

Dependent Variable: FDI to Brazilian Municipalities

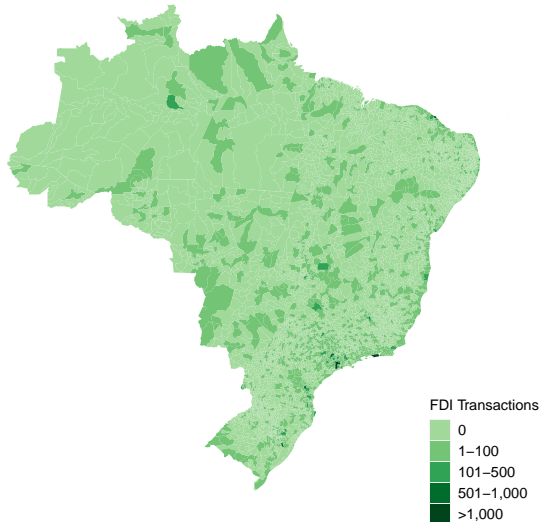


Figure 1: Number of FDI transactions by municipality, 2011–2021

Brazilian Politics: A Primer (I)

- ▶ National and state elections every 4 years, with midterm elections for mayors and city councils
- ▶ Nearly all municipalities follow a mayor-council government, with a strong-mayor system
 - ▶ We exclude the two municipalities that don't
- ▶ Very fragmented party system, with frequent party switching

Brazilian Politics: A Primer (II)

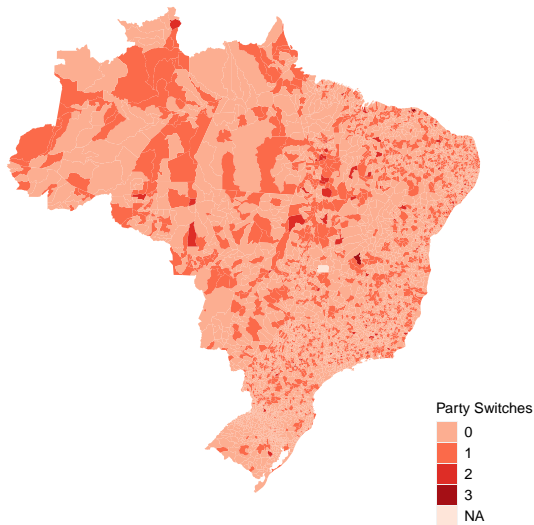


Figure 2: Number of times the same mayor switched parties during one term, 2017-2020

Measuring Political Alignment

- ▶ **Political alignment** indicates whether the mayor's party is aligned (i.e. votes) with the president's party in the lower house of Congress
 - ▶ Thresholds: 70, 80, **90% alignment**
 - ▶ Source: election results and voter registration records from the Electoral Court (TSE), matched with Congress roll call votes
- ▶ **Control variables:**
 - ▶ Politics: party switch, ideology, elections, and second term (all for mayors)
 - ▶ Economic geography: population density, GDP, infrastructure (airports and ports), skilled labor, economic concentration (Hirschman-Herfindahl index)

Empirical Strategy

- ▶ **Unit of analysis:** municipality-year
- ▶ **Model:** hierarchical negative binomial with random intercepts
 - ▶ **Why negative binomial?** Because our DV is a count variable with overdispersion
 - ▶ **Why hierarchical?** Because the data follow a multilevel structure: municipalities within the same state are more similar to each other than to municipalities from different states

Results

The Effects of Political Alignment

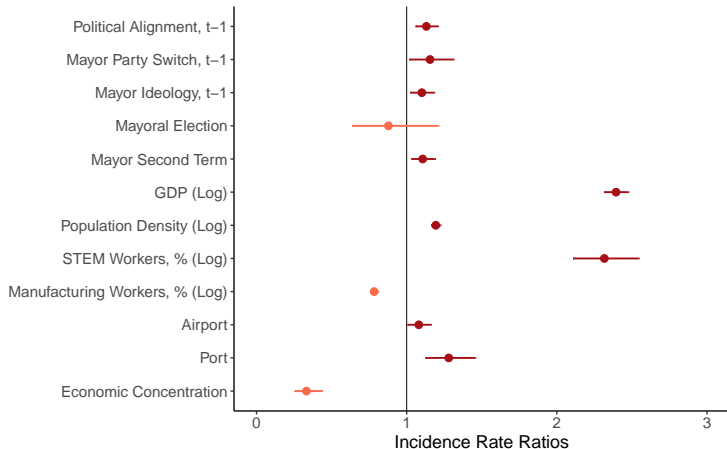


Figure 3: Politically aligned municipalities attract 12.8 percent more FDI transactions than non-aligned municipalities

Testing the Mechanisms

Alignment can increase FDI through...

- ▶ **Mechanism 1:** investment incentives
- ▶ **Mechanism 2:** intergovernmental transfers

We test these mechanisms in the North and Northeast regions of Brazil

Mechanism 1: Investment Incentives

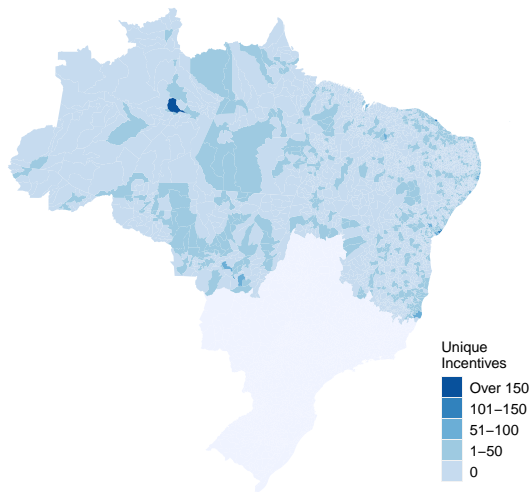


Figure 4: Investment incentives in the area under SUDENE's and SUDAM's jurisdictions, 2013–2021

Mechanism 2: Intergovernmental Transfers

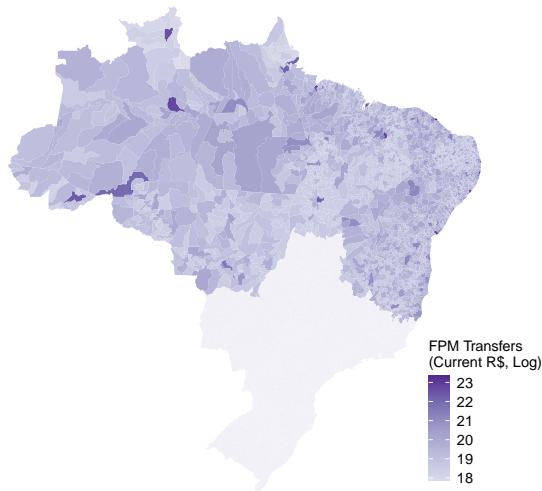


Figure 5: Intergovernmental transfers in the area under SUDENE's and SUDAM's jurisdictions, 2013–2021

Preliminary Results

Investment Incentives Appear to Matter Most

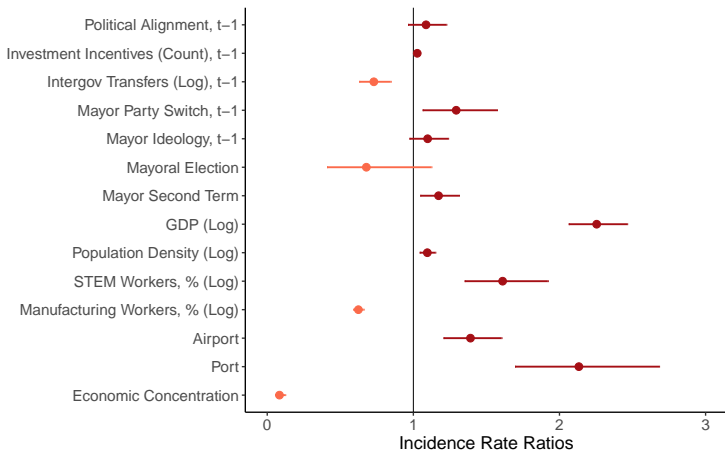


Figure 6: One additional investment incentive is associated with a significant 3 percent increase in the number of FDI transactions, whereas transfers have a negative effect

Next Steps

- ▶ We looked at alignment between the mayor and the president. What about the *governor*?
- ▶ We made FOIA requests to obtain better measures
 - ▶ *Value* of FDI transactions (not just count)
 - ▶ *Value* of investment incentives (not just count)
- ▶ We want to consider the implications for other countries with large geographic variation, highly fragmented party systems, and intense party switching

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Paper: www.iasmingoes.com/papers/Costa-Goes-Moehlecke.pdf