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Vote-seeking incentives and investment environments: The need for credit claiming and the provision of protectionism

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ABSTRACT

Incentives to cultivate a personal reputation encourage legislators to generate policy outcomes for which they can claim credit. We show that these incentives make themselves felt in international agreements – a domain that might typically be considered within the purview of the executive branch. Through a cross-national analysis and brief case studies, we show that countries with electoral systems that encourage personal vote seeking are more likely to negotiate exceptions to treaties meant to liberalize their investment environments. Legislators benefit by being able to claim credit for having protected their constituents from the competition an unrestricted agreement would entail.

1. Introduction

Legislators draw on their personal reputations and the reputations of their parties as they seek reelection. The relative importance of personal versus party reputations is in large part a function of the electoral rules candidates face. Where rules institutionalize intra-party competition among candidates, party reputations do not provide sufficient information for voters to make a choice. Under such rules legislators will seek out opportunities to personally claim credit for having looked out for the interests of prospective constituents.

Opportunities for position taking and credit claiming take many forms, and seeking to enhance one's personal reputation is possible in many of the daily activities of legislators. It has also been reasoned that the need to cultivate a personal reputation with (unorganized) voters will lead candidates to eschew the support of (organized) interest groups (Denzau and Munger, 1986) and that the relative effort devoted to courting unorganized and organized interests varies systematically with electoral rules (Bawn and Thies, 2003). Legislators engage relatively more in constituency service in an effort to generate a positive reputation with prospective constituents (Cain et al., 1987) and the amount of that effort varies systematically with the electoral rules they face (Heitshusen et al., 2005). During the policy-making process, personal vote-seeking incentives have been associated with the initiation of parochially targeted legislation (Crisp et al., 2004), assignment to district-oriented legislative committees (Stratmann and Bauer, 2002), and willingness to defect from the party line on roll call votes (Carey, 2007). We show that electoral laws that formalize personal vote-seeking incentives are also associated with exceptions to international agreements negotiated to liberalize investment environments, exceptions which protect domestic actors from foreign competition. In the next section, we provide an overview of these international agreements and the ability of organized interests to lobby for special protections from foreign competition.

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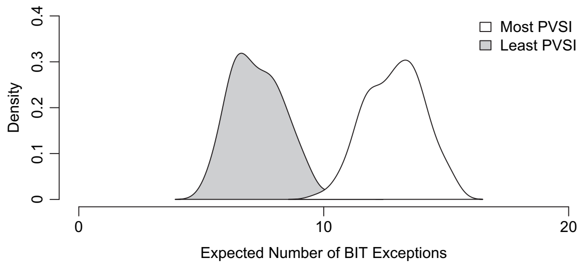

Fig. 1. Personal vote-seeking incentives (PVSI) and expected number of BIT exceptions.

2. Bilateral investment treaties and foreign direct investment

Bilateral investment treaties (BITs) – international treaties on the treatment of investment between two countries – reduce risks for multinational investors by increasing policy certainty, giving international investors the same rights and privileges that domestic investors enjoy. BITs are the result of complex negotiations between countries that in the end must be ratified by national legislatures. As a result, BITs are the product of political wrangling and compromise not only between countries but also within them. BITs generally open domestic economies to foreign direct investors, but they can also provide numerous exceptions protecting specific domestic industries. We reason that the ratification process introduces legislators' preferences into the process of negotiating international agreements (Schelling, 1960; Putnam, 1988) and that particularistic exceptions from an entirely liberalized environment are especially suited to building a personal reputation with a well-defined constituency (Weingast et al., 1981; Nielson, 2003).

Exploring the universe of U.S. bilateral investment treaties (treaties between the United States and other countries) provides us with a comparable measure of responsiveness to domestic constituencies. The U.S. offers a standard or model treaty to every nation, but, though these treaties begin the same, exceptions can be written into the treaty during the negotiation process.[1] We hypothesize that countries with electoral institutions that create incentives to cultivate a personal vote provide politicians greater incentives to respond to demands from special interests – leading to more exceptions. We test our hypothesis through a cross-national statistical analysis and closer examination of legislative politics in a few, selected cases.

The ability to attract foreign direct investment (FDI) is seen as one of the keys to economic development. BITs are international investment agreements between two states that outline reciprocal terms for the treatment of foreign investors in each country. Despite a proliferation of research on BITs, little scholarly work has examined the content of these treaties.[2] Implicitly the treaties are assumed to be identical to one another (Yackee, 2007, 2008).[3] Perhaps the most important variation within BITs is the extent to which they single out sectors for continued protected status. In examining the economic sectors precluded from facing foreign competition, we have a rare opportunity to evaluate the number of interests privileged by domestic politicians.

One of the more active BIT initiators is the United States. The U.S. signed its first BIT in 1982 with Panama, and now has signed BITs with over 46 countries, 39 of which have entered into force. The U.S. and partner government negotiate a schedule of sectors that they would like to be exempt from coverage in the BIT – sectors that will not be subject to competition from foreign direct investors on equal legal footing. All foreign governments attempting to sign a BIT with the U.S. face an initial treaty with the same structure, yet governments have the ability to seek exemptions for politically important industries. In the next section, we outline a theory of the incentives of individual politicians to negotiate exceptions for domestic economic actors.

3. Personal vote seeking and the investment environment

How legislators conceive of representation and the duties it entails is a function of the institutions that govern how they get and keep their jobs. From voters' perspective, the goal is to obtain the information necessary to discern among competitors. Where electoral rules pit copartisans against one another – under the use of an open-list, proportional representation ballot type, for example – a party reputation alone will not distinguish all competitors from one another. Where individual personal reputations have far greater vote-purchasing power than party reputations, candidates will focus on particularistic promises for which they can claim credit – such as exceptional language in a BIT. The beneficiaries of an exception to the BIT have a stake in ensuring their privileged status relative to foreign competitors. An exception to a BIT offering protection to particular domestic investors has obvious constituents – probably well-heeled constituents accustomed to making campaign

[1] The U.S. has had several model texts during the course of its BIT program, including the 1982, 1983, 1984, 1987, 1992, and 1994 models, with the most recent update coming in 2004. The models were very similar. Most importantly for our purposes, no model allowed exceptions for particular economic sectors in the body of the treaty, and all models required that any exceptions negotiated be listed explicitly in the main annex of the treaty.

[2] The BIT literature in political science has largely focused on two questions. First, numerous scholars have examined the impact of BITs on foreign direct investment (UNCTAD, 1998; Egger and Pfaffermayr, 2004; Neumayer and Spess, 2005; Salacuse and Sullivan, 2005; Tobin and Rose-Ackerman, 2005; Haftel, 2007; Yackee, 2008). A second area of focus has been explanations for the recent explosion in the number of BITs and the complex diffusion of these agreements across particular groups of countries (Guzman, 1998; Elkins et al., 2006; Simmons et al., 2006).

[3] Allee and Peinhardt (2008) is one of the few exceptions, examining the differences in arbitration mechanisms.

Table 1
Personal vote-seeking incentives and BIT exceptions.[a]

	Model 1	Model 2	Model 3
Personal vote-seeking incentives	0.061 (0.018)	0.062 (0.018)	0.064 (0.018)
Affluence of citizenry (GDP p/c)	0.232 (0.093)		0.310 (0.123)
Economic bargaining might (GDP)		0.049 (0.049)	−0.072 (0.065)
N	21	21	21
DIC	147	232	226

[a] Indicators for BIT model treaties not reported.

contributions, lobbying members of congress, and employing large numbers of prospective voters.[4]

The relative value of personal reputations versus party reputations to legislators is a function of just "four variables common to all electoral systems: ballot control, vote pooling, types of votes, and district magnitude" (Carey and Shugart, 1995, 418). Lack of party leadership control over access to and rank on ballots, the degree to which candidates are elected on votes not pooled with those of copartisans, and whether voters cast a single intra-party vote instead of multiple votes or a party-level vote enhance the value of a personal reputation. Where such rules are in place, candidates compete not only against members of other parties but also members of their own. District magnitude, the number of seats contested, heightens these incentives – making personal reputations more valuable as magnitude increases where there is intra-party competition. Thus, our focus is on the electoral laws that distinguish one democracy from another.

Nielson (2003) found that electoral rules that empower party leaders and minimize personal vote-seeking incentives are associated with liberalizing trade reform. He argued that the electoral laws allow party elites – who have the entire bloc's reputation in mind – to overcome the protectionist impulses of individual legislators. Based on a different sample of countries, Hankla (2006) reached a similar conclusion. He focused on the organizational centralization of parties and stable party linkages to large groups of the electorate as causal mechanisms. He contended that legislative logrolls leading to high protection were significantly less likely when parties are centralized. Utilizing a handful of in depth case studies, Woods (2006) concluded that personal vote-seeking incentives influenced how countries interacted with the IMF. Vote-seeking incentives were associated with efforts to stave off tough reform decisions and to keep in place interventionist policies despite financial crises which should have increased IMF leverage to bring about reforms.

Akin to these works, we seek to determine whether there is an electoral system effect on the foreign economic policy that defines the investment environment. Given that these agreements require legislative ratification, we reason that the implications observed in other policy areas will extend to the environment for foreign direct investment as defined by international accords.[5] We show that, beyond left-right preferences (for a more or less liberal investment environment), institutionally imposed electoral incentives that vary cross-nationally affect the content of

[4] Undoubtedly, personal vote-seeking legislators have prospective constituents who would prefer a liberal economy and unfettered foreign investment. However, there are several reasons why building a personal reputation is better achieved through protectionism than liberalization. First, the boilerplate agreement that would create the environment most advantageous for foreign direct investors is authored by the United States government, and as such would be difficult for a domestic legislator to claim credit for. What is more, credit for the uncluttered document goes to all members of the legislature who did not explicitly advocate exceptions and would, therefore, fail to distinguish individual legislators from one another. Second, a liberal investment environment, unlike pork-barrel legislation, for example, is not obviously targeted at a particular locale or electoral constituency. Certainly, some actors might prefer an environment open to U. S. capital, but exactly where that capital would end up is not known prior to the establishment of the BIT. A helpful anonymous reviewer pointed out that our logic could be captured with the framework put forward by Bawn and Thies. They reason that legislators will devote relatively less time to organized interests (interest groups) and relatively more time to unorganized interests (voters) in systems using single-member district plurality electoral rules. A positive personal reputation generates more votes in an SMD system because voters cast their vote at the level of the individual (and the party) as opposed to at the party level in list PR systems. Conversely, a bad reputation resulting from working on behalf of an unpopular organized interest will have a greater (negative) effect on vote share in SMD system for the same reason. This will encourage parties to nominate candidates with positive personal reputations in SMD systems. Because parties need not match candidates to districts in PR systems, their selection of candidates can be responsive to interest groups. The question is what are the preferences of organized interests and the preferences of unorganized interests in regards to BIT exceptions to foreign direct investment (FDI). Because most FDI is market seeking (trying to get access to the domestic market), and BIT exceptions protect domestic actors from that foreign competition, we could take these exceptions as anti-competitive and price increasing. Therefore, voters, or "unorganized interests" in Bawn and Thies terms, should oppose exceptions, while organized interests should ask for them. On the other hand, we might argue that unorganized interests (voters) prefer exceptions while organized interests seek a more open economy. While scholars and international institutions have identified attracting multinational investments as key development strategies, an older management literature on the "liability of foreignness" focused on the potential backlashes against the investments of multinationals. More recent survey research has identified mass opinions on MNCs as much more negative than those of elites. If we extend these sentiments to FDI, it may be the case that legislators can cater to unorganized voters by opposing unfettered BITs while elites, including leaders of organized interests, recognize the importance of FDI for growth. Our empirical tests indicate that SMD systems are most associated with BIT exceptions. Apparently legislators', or governments' more generally, desire to appease (unorganized) voters lead them to seek exceptions to completely unfettered investment environments.

[5] Thomas Schelling (1960) conjectured that the preferences of domestic actors could constrain treaty negotiators. Putnam (1988) formalized and made more explicit the logic. For a classic statement of why executive branch actors – such as treaty negotiators – anticipate legislators' preferences generally, see Moe (1987) and for an extension of the rationale specifically to the question of international treaties see Milner and Rosendorff (1997). It is not only that the preferences of domestic legislators can make treaty ratification more or less likely, but that, as a result, they influence the detailed contents of international accords (for recent specific examples emphasizing the constraining role of domestic legislators see Hug and König (2002) and Slapin (2006)).

international accords. A cross-national statistical test and examination of specific cases will show that where politicians face incentives to cultivate personal reputations, international accords are likely to contain language singling out domestic sectors for particularistic benefits.

4. Empirical analysis

The information for coding bilateral investment treaties came from the websites of the U.S. Department of State and Office of United States Trade Representative.[6] Because the U.S. negotiates from a limited set of model texts, the annex and protocols of the treaties (where individual BITs deviate from the model text) are ideal for testing our hypothesis. The common templates serve as a control against extreme variation that would likely obtain if each foreign BIT partner started the process of negotiation anew.[7] To code our dependent variable, we counted the number of exceptions to national and most favored nation (MFN) treatment negotiated into the agreement by the partner country. The number of exempted sectors ranged from 3 to 29. At the moment of writing, 39 BITs were in force between the United States and as many countries. However, several of these were signed with non-democracies where elected legislators did not exist (and thus, no vote-seeking incentives applied). Thus, our sample is pared down to only 21 observations.

Based on Carey and Shugart's (1995) classification of incentives to cultivate a personal vote we use a variable that ranks systems on a 13 point scale from most party centered to most personalistic.[8] This indicator of personal vote-seeking incentives is drawn from the Database of Particularism (Johnson and Wallack, 2005). The coding scheme accounts for ballot access and structure, the number and level of votes cast, the level to which votes are pooled, and district magnitude.[9]

Given the small number of observations with which we are working, an exhaustive list of controls is not possible.[10] However, one possible driver of exceptions to bilateral investment treaties is the relative economic clout of each country's citizenry. If negotiators are constrained by the preferences of domestic actors, it stands to reason that relatively affluent populations will have more resources with which to exercise influence. For example, the ability of citizens to make campaign contributions (or to pay bribes) could make politicians relatively more attentive to their demands. Thus, we control for the relative wealth of each country's citizens with GDP per capita (World Bank, 2005). Given that BIT content is jointly determined, we also control for the economic bargaining power of the partner country (measured as its GDP). We report models without controls and with controls added sequentially.

For counts of *exceptions*, we fit Poisson regression models.[11] We have cast our analysis in a Bayesian framework. The main reason behind our choice of Bayesian inference is that with a small set of observations we cannot rely on the asymptotic theory that underlies maximum likelihood. Bayesian estimators, instead, do not rely on large sample properties.[12] In our case, the sample size is practically identical to the population size, as we are including all BITs signed between a democratic regime and the U.S. However, we use diffuse prior distributions on parameters of interest, which means that our results are substantively similar to those obtained through maximum likelihood estimation even though they rest on firmer inferential grounds.[13] In Table 1, we present models that examine how the incentives to cultivate a personal vote affect the level of exceptions.[14] Given the Bayesian framework, the numbers reported in Table 1 are the means of the posterior distributions of the parameters, and the numbers

[6] They are http://www.state.gov/e/eeb/rls/fs/2006/22422.htm and http://www.ustr.gov/Trade_Agreements/BIT/Section_Index.html, respectively.

[7] Model texts have changed over time, with small changes adopted in 1982, 1983, 1984, 1987, 1992, 1994, and 2004. The number of BITs signed under each model are, respectively, 1, 2, 7, 7, 7, 19, and 1. None of these model templates listed exceptions within the body of the treaty.

[8] Including indicators for 12 nominal variables based on the Particularism scale would overwhelm our number of observations. How to break the scale into a series of categories on theoretical grounds is not obvious. However, examining our national cases, the observed data seemed to fall somewhat naturally into three categories. The scale, in theory runs from 1 to 13. We observed ten countries with a particularism score of 3 or less, three countries with a score of 5 or 6, and eight cases with a score of 10 or more. As a result, we created three categorical variables and ran models otherwise identical to those reported in Table 1 (where we use the full scale). Our conclusions remain the same. Systems with high personal vote-seeking incentives negotiate more BIT exceptions (though moderate and low cases were not discernible from one another in our alternate models using a categorical specification of the independent variable).

[9] In systems with multiple electoral tiers, the measure captures the tier highest in personal vote-seeking incentives.

[10] Random effects for templates are modeled but not reported. After conditioning on covariates, the data did not suggest extreme differences across templates in the number of exceptions negotiated.

[11] After dropping non-democracies and other observations with missing data on the electoral variables of interest, we are left with 21 observations: Albania, Argentina, Azerbaijan, Bolivia, Bulgaria, Croatia, Ecuador, Estonia, Grenada, Honduras, Jamaica, Latvia, Lithuania, Mongolia, Mozambique, Poland, Romania, Sri Lanka, Trinidad and Tobago, Ukraine, Uruguay.

[12] The desirable properties of ML estimators are justified only in large sample situations. In particular, measures of uncertainty about parameters of interest are heavily dependent on assumptions of asymptotic normality in MLE, but can be approximated to an arbitrary degree of precision through Bayesian MCMC simulation (Jackman, 2000).

[13] We stipulate proper but wide normal prior distributions for all effect parameters and random intercepts. In all cases, prior distributions are centered on 0 and have very low precision (0.001), which means that our inferences about coefficients are driven primordially by data in our sample and not by a priori information. Convergence was monitored using the Gelman-Rubin R-hat statistic and was swift and clean. We base our estimates on 200–300 thinned draws from the posterior distribution (thinned every 10th scan), after burnin runs of 10–15 thousand iterations.

[14] The countries in our sample are not significantly different than out-of-sample countries in terms of the incentives to cultivate a personal vote. Vote-seeking incentives are not a statistically significant predictor of whether a particular country signs a BIT with the United States. This need not mean that we can exclude the possibility of selection bias – i.e., that some uncontrolled factor correlated with vote-seeking incentives affects both the decision to sign a BIT and the number of exceptions – but it at least gives us reason to believe that countries in the sample (which have already signed a BIT) are not markedly different than countries out of sample (which have not signed a BIT) in terms of their electoral systems. In other words, it seems unlikely that the United States is seeking countries with specific electoral configurations. Interviews with staff at the Office of the United State Trade Representative indicate that the U.S. offers to negotiate a BIT with any country. The countries that take up the offer may not be random, but it seems unlikely that any source of potential bias lies with U.S. selection rules.

reported in parentheses are the standard deviations of those distributions.

The indicator of greatest theoretical interest has the expected sign – more specifically, personal vote-seeking incentives are associated with more exceptions to a completely liberalized investment environment. As hypothesized, the control for the affluence of citizens – which empowers them relative to their politicians – is positively associated with BIT exceptions. The control for the size of the country's economy – which empowers negotiators for the foreign signatory relative to the U.S. – was more susceptible to model specification.

Countries with electoral systems that encourage personal vote seeking the most are statistically discernible from countries with lower personal vote-seeking incentives. The Poisson specification makes it difficult to gauge the substantive magnitude of party/personal vote-seeking incentives. In Fig. 1, we plot the probability densities of the expected number of BIT exceptions under two alternative democratic regimes corresponding to high and low personal vote-seeking incentives while holding constant other covariates (based on model 1). For systems with the greatest incentive to cultivate a personal vote, we expect the number of exceptions to be between 11.15 and 14.7. Instead, for systems with the least incentive to cultivate a personal vote, we expect BIT exceptions to range between 5.8 and 9.3 (with probability 0.95). In other words, personal vote-seeking incentives help us understand variations in the foreign direct investment environments across BIT signatories. Each partner country seeks to reassure U.S. investors, but where electoral incentives encourage legislators to claim credit for personal accomplishments, the partner country is likely to exempt more sectors from competition with U.S. investors operating on equal legal footing.

The general trends identified in our models are borne out by case-specific examples. Members of the House of Representatives in Trinidad and Tobago, for example, are elected by plurality in single-member districts. In such instances, the low magnitude puts an emphasis on individual traits and accomplishments of the members. The BIT negotiated by Trinidad and Tobago lists 18 economic sectors already advantaged by pork-barrel subsidies and makes clear that foreign investors will not be eligible for such subsidies. Basdeo Panday of United National Congress (UNC) vociferously pursued protection for his constituents. Panday got his start in politics as the president of the Trinidad Islandwide Cane Farmers' Association (TICFA), and he was elected to parliament by the Couva North district, part of the region known as Trinidad's "sugar belt". Not surprisingly, Panday advocated that agriculture receive special treatment in any agreement opening up the economy, and he even suggested that representatives of the agricultural sector serve as part of the negotiating team (*Hansard*, 1994, 545).

The political wrangling and calls for exceptions captured in the pages of Trinidad and Tobago's *Hansard* contrast starkly with the *Actas* of Ecuador. Ecuador elects its National Congress from multimember districts using closed-list proportional representation rules. The incentive to build a personal reputation by catering to a particular electoral constituency is relatively low. In the BIT negotiated with the U.S., Ecuador sought protection for only two sectors – ownership of radio and television broadcast stations and traditional (*artesanal*) fishing. The government was clear that it was seeking foreign investment in commercial fishing, and that the exception did not apply to fish processing or aquaculture. The treaty was approved by the National Congress on September 1, 1994, with 86% of the legislators present voting in support of the treaty (*Acta*, 1994, 24). The secretary of the chamber read a brief (one paragraph) *pro forma* report from the Foreign Affairs Committee (*Asuntos Internacionales*) advocating the adoption of the treaty, and the chamber president called the vote, which was quickly taken by a show of hands. There was absolutely no discussion of the treaty, and its contents were read into the congressional record *after* the vote was taken.

Thus, our general results and a couple of case-specific examples provide support for the link between personal vote-seeking incentives and protection from foreign direct investors through exceptions to bilateral investment treaties. Countries with institutions that provide incentives for legislators to cultivate personal support are associated with substantially more exceptions. Where MPs face personal vote-seeking incentives, they openly lobby the government regarding the content of foreign agreements. They use debates on the chamber floor to press the government for exceptions protecting constituents. On the other hand, were MPs face party vote-seeking incentives, executive-proposed agreements sail through congress without much discussion, let alone modification.

5. Conclusion

Focusing our investigation on the relationship between legislators' incentives and foreign direct investment in a small number of cases – signatories to U.S. BITs – imposed several limitations on our efforts. Most obviously, it made implementing a full set of controls and testing alternate model specifications impossible. Despite that cost, our research design decision is critical to the generalizability of our findings. Constructing a scale of investment liberalism would be a daunting task, and actually finding observable indicators of that scale that traveled well across national cases would be still more challenging. By starting with a standard, completely liberalized treaty instrument that clearly identified the placement of exceptions taken by each signatory, we can be confident that the indicator of our dependent variable is consistent across cases.

We employed a widely cited indicator of legislators' electoral incentives. Carey and Shugart's (1995) identified ballot access and type, level of vote pooling, number of votes cast, and district magnitude as the institutional features which determine whether candidates will seek to cultivate the shared reputations of their parties or their own personal reputations. Johnson and Wallack (2005) used Carey and Shugart's theory to develop a classification scheme moving from the most party centered to most personalistic electoral systems, which they applied to the democracies of the world. Previous work has confirmed a relationship between legislators' electoral incentives and a variety of economic policies, including government spending patterns, fiscal balances, and tariff levels. We have shown that even when a foreign superpower offers countries an identical blueprint for policy design, electoral incentives lead them to end up with quite different investment climates. More specifically, domestic electoral institutions in part determine the extent to which the investment environment is liberalized in the face of U.S. pressure to create an entirely unfettered domestic market. The fact that BITs must pass through a legislative ratification process introduces legislators' preferences into the equation for explaining the variation in treaty content across national cases.

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