

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

Ariana Ribeiro Costa<sup>†</sup>    Iasmin Goes<sup>‡</sup>    Carolina Moehlecke<sup>§</sup>

31 March 2024

## Abstract

Research shows that country-level characteristics like regime type, political stability, and partisan cycles shape the location decisions of multinational corporations (MNCs) for a given host country. Yet we know much less about the influence of local politics in such investment decisions. This is an important topic because local governments are often directly involved in foreign investment attraction: they set up investment attraction offices, organize business missions to foreign countries, and have the legal authority to allocate incentives and subsidies. Using new data on effective FDI transactions to Brazil at the host municipality level between 2011 and 2021, this paper examines how political alignment — a crucial aspect of local politics — influences FDI attraction. We conceptualize political alignment as the situation in which the mayor’s party is a member of the president’s support coalition in Congress. We find that political alignment increases the number of FDI transactions at the municipal level, but this effect is conditional on regional factors: local politics matter more in municipalities that are less attractive to investors. Taken together, our results add to the understanding that global economic integration produces highly heterogeneous effects within a given country, as the strength of political factors in explaining such variation is conditional on local economic patterns.

## 1 Introduction

Foreign direct investment (FDI) plays a crucial role in global politics, but its impact also manifests at the local level. Inward foreign capital brings substantial benefits to the local host economy (Bunte et al. 2018; Jensen and Rosas 2007), to the point of boosting local politicians’ electoral prospects (Owen 2019). Consequently, subnational representatives spare no effort in trying to attract FDI to their areas: among other strategies, they promote overseas investment missions (McMillan 2009), set up international investment offices and promotion agencies (Bauerle Danzman and Slaski 2022), and distribute generous investment incentives (Baccini et al. 2018). These initiatives allow local politicians to claim responsibility for investors’ decisions (Jensen and Malesky 2018). But what aspects of subnational politics, if any, effectively play a role in attracting FDI to specific states and

---

\*We thank audiences at EPSA 2023 and at FGV RI’s and Colorado State University’s research seminars for helpful feedback. We are grateful to Apex-Brasil, the Brazilian Trade and Investment Promotion Agency, for sharing municipality-level FDI data with us. We also thank Gabriel Camargo, Augusto de Oliveira and Rafael Villela for excellent research assistance.

<sup>†</sup>Fundação Getulio Vargas, [ariana.costa@fgv.br](mailto:ariana.costa@fgv.br)

<sup>‡</sup>Colorado State University, [iasmin.goes@colostate.edu](mailto:iasmin.goes@colostate.edu)

<sup>§</sup>Fundação Getulio Vargas, [carolina.moehlecke@fgv.br](mailto:carolina.moehlecke@fgv.br)

municipalities? This paper examines the effects of political alignment between mayors and the central government on FDI allocation at the municipal level.

We expect municipalities to attract more FDI when their mayors are the central government's co-partisans or political allies. Local-level allies are better positioned to grant advantages to foreign investors in the short term, facilitating business at the moment they enter the host municipality. We posit that political alignment provides advantages to investors through two channels. First, it should facilitate access to investment incentives redirected from the national to the subnational level. Access to these resources is crucial when investors are first entering a host municipality. Second, political alignment should increase intergovernmental transfers used to provide public goods like infrastructure and education, which foreign investors value. Still, we do not expect political alignment to have a positive effect on FDI across the board. This effect should be less pronounced in regions that already are attractive to investors. Dynamic, diversified municipalities that are abundant in skilled labor and display good infrastructure are already pursued by investors, rendering political factors less relevant for investment decisions (Simmons et al. 2018). In contrast, less dynamic regions should benefit from political alignment, which can signal to investors that there might be some advantages in investing in these usually less attractive areas.

We test our hypotheses using a new dataset of all FDI transactions received by each Brazilian municipality between 2011 and 2021. Brazil, the world's second-largest recipient of FDI in 2023 (behind only the United States),<sup>1</sup> displays striking variation across its municipalities in terms of local politics and regional factors that investors value. Crucially, Brazil's political system is characterized by high party fractionalization and intense party switching, which implies enormous variation in political alignment across space and time. Given the hierarchical structure of our data, with 5,570 Brazilian municipalities nested within 26 states, we estimate multilevel negative binomial models with random state and time effects, controlling for several municipal-level political, social, and economic covariates.

Findings show a positive and statistically significant effect of political alignment on the count of FDI transactions per municipality, which is robust to different specifications. These positive effects are conditional, though: they are more pronounced in municipalities that display high levels of economic concentration, that is, in less dynamic areas that are less desirable to investors. Political alignment signals to investors that there might be some advantages in investing in these less dynamic, more concentrated areas that may compensate for the lack of other valuable regional attributes. Finally, we test whether the effects of political alignment are mediated by investment incentives and intergovernmental transfers, two advantages that aligned municipalities might have over non-aligned ones. The results are mixed, indicating that more research is needed to unveil the relationship between alignment and FDI attraction.

There is a growing effort to acknowledge the interface between local and global political economy (Ballard-Rosa et al. 2021; Rickard 2022), especially by extending the topic to developing countries (Rickard 2020). We contribute to this effort in two ways. First, our results reinforce the relevance of subnational politics beyond partisanship and ideology, two aspects that have dominated the literature thus far (Pinto and Pinto 2008; Weymouth and Broz 2013; Garriga 2022). Given the enormous variation in domestic politics between and within countries, it is crucial to consider additional dynamics like political alignment (Simmons et al. 2018). Beyond Brazil, our findings likely translate to countries like Indonesia, Morocco, Slovenia, and Tunisia, which have high party fragmentation (Cruz et al. 2021), or Ecuador, Italy, Japan, and the Philippines, which have high levels of party switching (Desposato 2006). Second, we highlight how persistent economic factors condition the effects of local politics on FDI attraction.

---

<sup>1</sup><https://www.oecd.org/investment/statistics.htm>

## 2 Literature Review: The Role of Local Factors in Attracting FDI

Most of the literature in international political economy studies the national-level determinants of FDI attraction (Pandya 2016). This includes bilateral investment treaties (Elkins et al. 2006), investor-state dispute settlement clauses (Moehlecke and Wellhausen 2022), the quality of property rights (Jensen 2003; Li and Resnick 2003), screening requirements in strategic sectors (Bauerle Danzman and Meunier 2023), local content requirements (Pandya 2014), tax and regulatory policies (Li 2006; Jensen 2012), partisan cycles (Pinto and Pinto 2008; Pinto 2013), party structure (Simmons et al. 2018), and respect to human rights (Blanton and Blanton 2007). However, the role of state and local politics in attracting foreign capital remains largely underexplored, save for some selected contributions.

One question approached by this modest yet growing literature is how the partisanship and ideology of state and local governments affect their ability to attract investment. For instance, Garriga (2022) finds that multinational corporations (MNCs) prefer Mexican states ruled by left-wing governors, who are more likely to invest in human capital. In contrast, right-wing mayors in Brazil are associated with more business creation than their leftist peers (Arvate and Story 2021); and in the US, Republican-governed states experience a boost in investment from China (Lu and Biglaiser 2020) and in the manufacturing sector (Wang and Heyes 2021), relative to Democrats. As a compromise, Halvorsen and Jakobsen (2013) posit that divided state governments attract more FDI in the US; since Republicans support low taxes and Democrats invest in public goods provision, a mix of both approaches is most appealing to MNCs.

There is also growing interest in understanding whether investment incentives affect firms' subnational location decisions. The general answer is no: incentives sweeten the deal for firms that would have chosen a given location anyway (Oman 2000; Jensen and Malesky 2018). But much of the evidence comes from the OECD (e.g. Jensen 2012). In developing countries, at least some incentives appear to make a difference: lower corporate income taxes and longer tax holidays attract more investment to Latin America (Klemm and Parys 2012), and tax cuts on direct investment profit increase FDI to some Russian jurisdictions (Baccini et al. 2014). More broadly, firms that receive incentives are often already embedded in local markets, in sectors that conform to governments' broader economic policy goals (Bauerle Danzman and Slaski 2022), at least in Latin America. This is yet another indication that subnational politics matter for investment attraction.

Of course, other determinants of the subnational allocation of FDI must be considered. Among social issues, low education levels, low trust in state authorities, high delinquency rates, and organized crime competition significantly reduce FDI inflows, as shown by the study of Mexican states (Escobar Gamboa 2012; Samford and Gómez 2014; Garriga and Phillips 2022). Moreover, economic geography plays an important role in predicting the subnational location of inward FDI. One key driver of regional variation in FDI is agglomeration, that is, geographic clustering (Glaeser et al. 1992; Duranton and Puga 2001; Knoblen 2009; Rodríguez-Pose and Crescenzi 2008). Business activities, especially those of high added value, tend to cluster in large cities, as these offer more competitive consumer markets, knowledge-based services (like finance and accounting), transportation networks (including airports, ports, and roads), and telecommunications infrastructure (Storper and Venables 2004; Duranton and Puga 2001). Granted, large cities often display "diseconomies of scale," such as high rental costs, congestion, and higher salaries, which may encourage firms to spread to contiguous cities. But this, in turn, bolsters the development of metropolitan areas, an important determinant of firm location itself (Crescenzi et al. 2019).

Agglomeration generates at least two positive externalities (Feldman and Audretsch 1999; Duranton and Puga 2001; Beaudry and Schifffauerova 2009; Wang et al. 2016). The first, specialization, refers to knowledge flows exchanged *within* one sector. Specialized areas are home to a large pool

of skilled workers who provide knowledge spillovers and foster economies of scale (Beaudry and Schiffauerova 2009). In particular, MNCs provide knowledge spillovers to domestic firms, which tend to have less advanced managerial and technological capabilities (Ascani and Gagliardi 2020; Crespo and Fontoura 2007; Morales and Moreno 2020). The second positive externality, diversification, enables knowledge sharing *between* different sectors, generating new ideas across activities (Storper and Venables 2004). The complementarity between diverse industries and specialized services helps attract new investment (Duranton and Puga 2001). For complex economic activities, location decisions depend on business opportunities and innovation to a greater degree than on lower costs and economies of scale. To leverage these benefits, firms favor regions with high absorptive capacity, which is the ability to assimilate external knowledge flows and depends on pre-existing knowledge sources like universities and local firms (Cohen and Levinthal 1990; Miguélez and Moreno 2015; Anselin et al. 1997; Feldman and Audretsch 1999; Cohen et al. 2002). In contrast, areas with lower levels of agglomeration are often characterized by high concentration of one or a few economic activities, which discourages FDI due to missing economic dynamism.

There are two takeaways from this literature review. First, subnational politics matter for explaining variation in FDI inflows within a host country, but we need to expand the focus beyond ideology and partisanship to account for other political factors. Second, local politics does not happen in a vacuum. To the extent that local politics helps attract or repel FDI, this effect is moderated by a municipality's pre-existing social characteristics and economic structure. Thus, what is missing from the literature is the interplay between local politics and economics. In what follows, we argue that political alignment – the extent to which local politicians are allies or opponents of the central government – shapes FDI inflows at the municipality level, but always conditional on the economic and social structure in which municipalities are embedded.

### 3 Argument

We begin by assuming that foreign investors make their location decisions in a sequential process, first choosing a host country and then deciding on a more specific location (Mataloni Jr 2011). Within a host country, we expect foreign investors to favor municipalities whose local governments are politically aligned with the central government, all else equal. Our reasoning is not that investors fully understand the specifics of local politics. Rather, political alignment signals to investors that the municipality is more likely to obtain resources from the allied central government that can benefit the MNC, especially in the short-term. At the point of entry, foreign firms often need to overcome information asymmetries and thus demand some indications of policy stability that will allow the investment to establish itself and further develop; otherwise, they may choose another location (Barry 2018). Considering that investors' reasoning about where to locate abroad is multidimensional and often responds to broad considerations (Maitland and Sammartino 2015), political alignment is a factor that can reduce the liability of foreignness for MNCs at the local level (Belderbos et al. 2020). From this general reasoning, we derive our first hypothesis:

*H1: Aligned local governments will attract more FDI than non-aligned ones.*

Our proposition that political alignment is a positive cue for investors does not imply that it is the only or even the most important factor shaping foreign investors' decisions for a given municipality. Regional agglomeration, economic diversification, and factors related to good infrastructure and skilled labor supply are key predictors of MNCs' siting decisions, as these factors are crucial for enhancing firms' productivity. It follows that the effects of political alignment should be less prominent in locations that already are attractive to foreign investors. Larger municipalities, for example, tend to exhibit more agglomeration and higher diversification, as well as better access to infrastructure, transportation networks, and abundant skilled labor. The ability of these

municipalities to attract FDI should be less dependent on politics, as they already display several of the characteristics that investors value (Belderbos et al. 2020). In contrast, the impact of local politics should be more discernible in smaller, less dynamic municipalities, which usually have lower agglomeration, worse infrastructure, a smaller and less skilled labor supply, and whose economy is often concentrated in one or a few activities. These municipalities are not readily attractive to foreign investors, though they exhibit a few advantages relative to large cities, which are often plagued by diseconomies of scale, such as crime, high rental costs, and traffic congestion. We contend that political alignment in smaller municipalities tilts the scale in their favor, as it signals to investors that the local government can obtain resources from the central government that will benefit the investor at the point of entry, thus compensating for its lack of attractiveness, at least partially.<sup>2</sup> Thus, we derive our second hypothesis:

***H2:** The effects of political alignment on FDI attraction are conditional on regional characteristics: alignment will produce larger effects in less attractive municipalities for investors.*

We consider two main mechanisms through which aligned municipalities can attract more FDI. First, the central government should be more likely to prioritize its local allies when conceding investment incentives, such as tax breaks, subsidies, capacity-building programs, and related policies that streamline regulatory processes and reduce bureaucratic hurdles for foreign investors. Second, the central government should be more likely to benefit aligned local governments in granting funding for projects related to transportation, utilities, and technology, which potential investors find attractive.

We first discuss the possibility that political alignment increases the odds that local governments receive central government resources for investment incentives. In decentralized federal systems, state and local governments often have the legal mandate to engage in investment attraction: they can grant tax and non-tax incentives, sell land at lower prices, and offer cheap credit to MNCs. But even in these systems, the main actor responsible for investment attraction remains the central government, which provides resources for investment incentives to subnational entities. Despite research showing that incentives rarely change firms' locational decisions in OECD countries (Jensen 2012; Jensen and Malesky 2018), there is some evidence from the developing world that incentives make a difference (Klemm and Parys 2012; Baccini et al. 2014). Given that host governments strategically grant incentives to cultivate investment in areas that fulfill their broad development goals (Bauerle Danzman and Slaski 2022) and to signal support for high-quality investment projects to voters (Jud 2023), it is plausible that political alignment attracts more FDI at the local level because aligned governments will be more effective in garnering incentives from the central government.

***Mechanism 1:** Aligned local governments will attract more FDI because they have access to more investment incentives.*

The second possible channel through which political alignment could lead to more FDI is that it should enable coordinated efforts in infrastructure development. In Brazil, Chile, India, Portugal, the US, and elsewhere, intergovernmental transfers are driven by political considerations (see, respectively, Litschig 2012; Alberti et al. 2022; Arulampalam et al. 2009; Migueis 2013; Berry et al. 2010). Put simply, presidents allocate more transfers to co-partisan mayors (Ha and Jenkins 2024). When co-partisan mayors receive more transfers, they are better able to invest in the provision of public goods like infrastructure (Brollo and Nannicini 2012), crime reduction (Alberti et al. 2022), and education (Litschig and Morrison 2013). This, in turn, might make these municipalities more

---

<sup>2</sup>This rationale is consistent with Li (2006), who argues that countries with a weaker rule of law grant more incentives in an attempt to compensate for the poor institutional environment.



attractive to foreign investors: given MNCs' demand for roads, ports, energy, safety, and skilled labor (Bresslein et al. 2019), municipalities that invest more heavily in these sectors should provide a larger return on investment.

***Mechanism 2:** Aligned local governments will attract more FDI because they have access to larger intergovernmental transfers.*

Yet there is reason to be skeptical of this latter mechanism. While political alignment increases intergovernmental transfers in general, there is mixed evidence that such transfers actually lead to increased public goods provision at the local level. In Brazilian municipalities, for example, transfers have no effect on education or health and only a small effect on literacy rates (Gadenne 2017); some transfers are in fact associated with an increase in corruption (Brollo et al. 2013), which may hurt FDI attraction (Zhu and Shi 2019).<sup>3</sup> Even if transfers are properly implemented and end up generating public goods that investors value, it might take a long time for these resources to effectively materialize as roads, ports, or a skilled labor force, so we expect this channel to be less effective in explaining why aligned governments should attract more FDI.

Regardless of the mechanism, a cohesive approach between local and central authorities likely instills confidence in foreign investors, who have the strongest bargaining position when negotiating upfront deals. In democracies, political alignment is bound to change over time: today's local level ally might lose future elections to a political foe who does not see eye to eye with the central government. But future changes in political alignment are less likely to impact the investment terms already in place, and even if they do, investors have limited exit options once they commit to a specific location. For this reason, we expect foreign firms to care most about political alignment during the initial investment phase, which makes the investment incentives mechanism more plausible.

## 4 Data and Methods

We test our hypotheses using subnational data from Brazil, the largest FDI recipient in the developing world (UNCTAD 2022). We argue Brazil is an ideal case for our study because of the high variation its 5,570 municipalities exhibit across our variables of interest. Our period of analysis spans from 2011 to 2021.

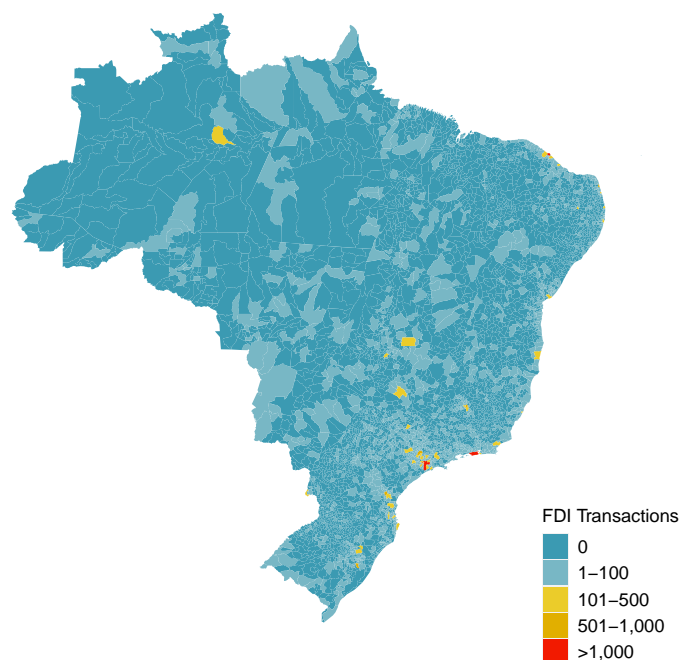
### 4.1 Dependent Variable: FDI Transaction Count

We build our dependent variable using data from the Brazilian Central Bank and organized by Apex-Brazil (Agência Brasileira de Promoção de Exportações e Investimentos). From January 1, 2011 to December 31, 2021, the Brazilian Central Bank recorded 51,103 unique inward FDI transactions into the country. We collapse all FDI transactions to each Brazilian municipality and year into the variable *FDI Transaction Count*. We use count because information about the value of each transaction is not available. Although the count of transactions may hide important variation across investments' values, these two measures should be largely correlated. Using the count is also conceptually sensible in our context: each count represents a foreign investor's decision to allocate its capital in a given municipality. An analysis of the geographic distribution of the transaction counts shows that it largely conforms to expectations, as Figure 1 illustrates. Excluding São Paulo and Rio de Janeiro — with 20,272 and 5,777 transactions, respectively —, the average municipality attracted 0.409 transactions, and 4,414 did not attract a single transaction during this period.

---

<sup>3</sup>Under certain conditions, though, corruption may also help attract FDI (Zhu and Shi 2019).

**Figure 1:** *Count of FDI Transactions to Brazilian Municipalities, 2011–2021*



## 4.2 Independent Variables: Political Alignment and Regional Factors

Our main independent variable is *Political Alignment* between the local and central governments. Brazil is a presidential democracy whose federal structure grants significant autonomy to its 5,570 local governments, sorted into 26 states and one federal district. The entire country holds general elections for president, state governors, and the national Congress every four years, with midterm elections for mayors and city councils. All municipalities follow a mayor-council system, meaning a directly elected mayor holds substantial executive powers.<sup>4</sup>

We use data from the Superior Electoral Court (Tribunal Superior Eleitoral, TSE) to identify the winner of all mayoral elections in 2008, 2012, 2016, 2020, and in over 500 special elections held in years in between, used to fill vacant mayor seats.<sup>5</sup> We match this with public voter registration records to track each mayor's party affiliation every year, thus accounting for party switches. The resulting measure of *Political Alignment* takes the value of 1 if the mayor's party is a member of the president's support coalition in the lower house of the National Congress and 0 otherwise. We consider that a party is a member of the president's support coalition if the voting recommendation issued by its leadership aligns with the voting recommendation of the president's party at least 90 percent of the time. Our measure builds on and improves upon a similar measure for local-level alignment in Brazil developed by Power and Rodrigues-Silveira (2019): we account for party switching and special elections, expand the coverage until 2021, and are more explicit about the criteria for determining support coalition. Since investors respond to recent but not immediate political factors, we examine the effects of *Political Alignment* on *FDI Transaction Count* at time  $t - 1$ . In Table A.1 of the appendix, we also present models using *Political Alignment* at  $t$  and  $t - 2$ . Relatedly, Table B.1 estimates a model with a narrower definition of alignment that only takes the value of 1 if the mayor and the president belong to the same party, in addition to models with less strict alignment thresholds (70 and 80 percent).

<sup>4</sup>There are only two exceptions: the capital Brasília does not have a local-level government, and the island of Fernando de Noronha has a city manager appointed by the state government of Pernambuco. Both are excluded from our discussion and subsequent analysis.

<sup>5</sup>Special elections (Eleições Suplementares) usually take place when the elected mayor is suspended from office because of involvement with corruption or other irregularities.

The Brazilian party system is highly fragmented (Samuels and Zucco 2014), which implies substantial variation in political alignment over time. In the 2010 national election, for example, the 513 elected deputies for the lower house of the National Congress came from 22 different parties, a number that rose to 30 in 2018 (Caesar 2018). The Database of Political Institutions' fractionalization variable, which measures the "probability that two deputies picked at random from the legislature will be of different parties" (Cruz et al. 2021) and that ranges from 0 to 1, attributes an average value of 0.93 to Brazil between 2011 and 2020. This high fractionalization is associated with politicians' high mobility across parties (Desposato 2006). Even presidents change parties: Jair Bolsonaro was elected as a member of the now defunct far-right party PSL in 2018, but spent much of his presidential term as an independent and only rejoined far-right party PL in 2021. Yet, party switching is more widespread among local politicians, who often join the party of a newly elected president or governor to gain influence and privileged access to federal and state resources. For example, from 1994 until 2022, the governor of the state of São Paulo was always a member of the center-right party PSDB. But after PSDB lost the 2022 gubernatorial elections, 60 mayors left the party within six months (Ferraz 2023). This means that nearly 10 percent of São Paulo's 645 municipalities experienced a switch. While the median mayor does not change parties during a four-year term, our data show that some mayors change as many as three times.

According to *H2*, the effect of *Political Alignment* on *FDI Transaction Count* is conditional on regional factors, which also vary extensively across Brazilian municipalities. Following the specialized literature, we consider the effects of three groups of regional factors in our analysis: agglomeration levels, location advantages, and degree of concentration. To recap, agglomerated municipalities are those where economic activities tends to cluster, generating both specialization and diversification. Location advantages refer to local characteristics such as availability of high skilled labor and transportation infrastructure. Investor usually seek municipalities with high levels of agglomeration and location advantages. In contrast, concentrated municipalities are defined as locations with only one or a few economic activities. By definition, concentrated areas are not diverse, and although they may display some level of specialization, these are typically in low-technology activities. Concentrated areas are not particularly attractive to foreign investors.

Specifically, we consider *GDP* and *Population Density* as indicators of agglomeration. We measure municipalities' GDP in current Brazilian reais (logged) and population density (total population divided by total area, logged), using data from the Brazilian Institute of Geography and Statistics (IBGE). The coefficients for these proxies of agglomeration should be positive and significant, following the expectation that agglomerated areas attract more FDI.

We consider the effects of two types of regional factors: one connected to the availability of a skilled workforce and another associated with infrastructure. For the first one, we consider the percentage of STEM workers (engineers, mathematicians, statisticians, computer scientists, physicists, chemists, and biologists, as labeled by the Brazilian Classification of Occupations) and workers in the manufacturing sector, using the Ministry of Labor's RAIS database. Both variables are logged. As for the group of infrastructure factors, two variables indicate the presence of public airports and ports (maritime, river, or lake), reported by the Civil Aviation Agency and the Customs Authority, respectively. We expect these four variables to display positive and significant effects, given previous research showing that they are important predictors of FDI attraction at the local level (Mataloni Jr 2011; Maitland and Sammartino 2015; Belderbos et al. 2020).<sup>6</sup>

Finally, we operationalize degree of concentration using the Hirschman-Herfindahl (HH) index, calculated as the sum of the squared share of workers in each sector (following the sectors set by the National Classification of Economic Activities). We obtain these data from the Ministry of Labor's

---

<sup>6</sup>In Table C.1 of the appendix, we also include a measure of "diseconomies of scale:" the municipality's homicide rate (out of 100,000), reported by the Institute of Applied Economic Research (IPEA). We do not include this variable in the main analysis due to a large number of missing observations for small municipalities, but following Escobar Gamboa (2012), we expect higher homicide rates to dampen FDI.



**Table 1:** *Variation in Regional Factors Across Brazilian Municipalities, 2021*

Variable	N	Mean	Std. Dev.	Min	Max
GDP (Log), R\$	5570	12.67	1.42	9.80	20.54
Population Density (Log)	5564	3.28	1.45	-3.46	9.59
STEM Workers, %	5570	0.32	0.28	0	3.47
Manufacturing Workers, % (Log)	5570	1.97	1.31	0	4.46
Port	5570				
... No	5516	99%			
... Yes	54	1%			
Airport	5570				
... No	5087	91%			
... Yes	483	9%			
Economic Concentration	5570	0.33	0.23	0.04	1

RAIS database. When employment is diversified, the HH index is closer to zero; when workers cluster in just a few sectors, the index is closer to 1. If high concentration discourages foreign investment, as expected, then the coefficient for the HH index will be negative and significant.<sup>7</sup>

Table 1 displays the large variation found across our variables measuring agglomeration, location advantages, and concentration for the most recent year in the analysis. By focusing on a country with substantial variation across regional factors, we can isolate its differential effects on FDI attraction and increase the generalizability of our results.

### 4.3 Mechanisms: Investment Incentives and Intergovernmental Transfers

We test our mechanisms using a subset of municipalities within the jurisdiction of two autonomous federal agencies charged with regional development goals. According to the Brazilian constitution, 3% of all income taxes and taxes on industrialized goods levied by the federal government must go to regional development funds managed by autonomous federal agencies. The two largest such agencies are SUDENE (Superintendência do Desenvolvimento do Nordeste), which covers 2,074 municipalities in the northeast, and SUDAM (Superintendência do Desenvolvimento da Amazônia), which encompasses 772 municipalities in the north. Together, SUDENE and SUDAM cover nearly 80 percent of the Brazilian territory.<sup>8</sup> Figure 2 shows the spatial distribution of our two proposed mechanisms – intergovernmental transfers and investment incentives – within the jurisdiction of the two aforementioned agencies, using data from 2013 to 2021. Though the focus on SUDENE and SUDAM reduces the geographical and temporal scope of our analysis, it also allows us to examine the competing effects of our proposed mechanisms in the country’s two poorest regions, which are characterized by lower levels of agglomeration, more concentration, and less infrastructure and skilled labor. Put simply, these are the two regions where political factors are bound to matter most for investment attraction.

<sup>7</sup>Pearson correlation tests between our measures of agglomeration and location advantages and concentration indicate a negative and substantively weak correlation (from -0.09 to -0.20). This reinforces the theoretical claim that agglomeration, location advantages, and concentration, while related, refer to different regional factors that investors take into consideration. The only correlation displaying a stronger effect is that between the share of manufacturing workers and economic concentration (-0.46).

<sup>8</sup>The remaining agency, SUDECO (Superintendência do Desenvolvimento do Centro-Oeste), operates in the central-west region, is little known, and does not offer investment incentives.

According to Mechanism 1, investment incentives might explain the relationship between political alignment and FDI. SUDENE and SUDAM offer tax deductions and cheap credit to firms investing in the country’s poorest states, prioritizing small and medium enterprises in rural areas (Horsth et al. 2021). Any firm – foreign or domestic – investing within the jurisdiction of SUDENE or SUDAM can apply for a 75 percent reduction in corporate income taxes and reinvest 30 percent of its remaining income tax balance on equipment modernization or working capital. While SUDENE has been linked to a 30% increase in local employment in the tourism sector from 2002 to 2009 (Garsous et al. 2017), others describe it as “a huge patronage operation” (Ames 2002, p. 256) that is manipulated by subnational political elites (Sugiyama and Hunter 2013, p. 47). If local-level allies have better access to development funds and secure more generous incentives, they might be in a better position to attract FDI, as we predict. We measure the number of unique tax rebates granted to all firms in each municipality and year by the two agencies, as it is difficult to quantify the amount of taxes that go unpaid because of these rebates.

As per Mechanism 2, aligned mayors might attract more FDI because they have access to larger intergovernmental transfers. We have evidence that mayors request – and receive – more intergovernmental transfers when they are aligned with the party that controls the federal government (Meireles 2018; Litschig 2012), which is consistent with the intense party switching we observe in Brazil. This is the case not only for discretionary transfers, but also for supposedly rules-based programs like the Municipal Participation Fund (Fundo de Participação dos Municípios, FPM), which distributes revenue from income taxes and taxes on industrialized goods to municipalities based on local population estimates. As Litschig (2012) shows, FPM population estimates are often manipulated for political purposes. Presidents face an incentive to meet allies’ requests for more transfers: these transfers can sustain the loyalty of local party leaders, secure their reelection, and ensure that local-level success provides momentum for the party at the national level (Migueis 2013). Following Litschig (2012), we focus on one type of intergovernmental transfer: the revenue-sharing grant FPM, funded by federal income taxes and taxes on industrialized goods. The FPM transfer allocation formula categorizes municipalities into sixteen population brackets; in 2021, only 193 municipalities met the population threshold of 156,216 needed to receive the maximum amount of funding. We report the log of FPM transfers received by each municipality, in Brazilian reais, using data from the National Treasury. In robustness checks, we replace this with two other intergovernmental transfers: oil royalties and the education grant FUNDEB.

#### 4.4 Control Variables

We control for a series of political factors that might affect investment location decisions. *Mayor Party Switch*, drawn from TSE data, indicates whether one single mayor changed parties from one year to another; a change prompted by the election of a new mayor from a different party does not count as a switch. We have mixed expectations about party switching. On the one hand, a switch to the president’s party – from non-alignment to alignment – might increase access to both investment incentives and intergovernmental transfers, thus promoting FDI. On the other hand, it might lead to political instability (actual or perceived), thus reducing FDI.

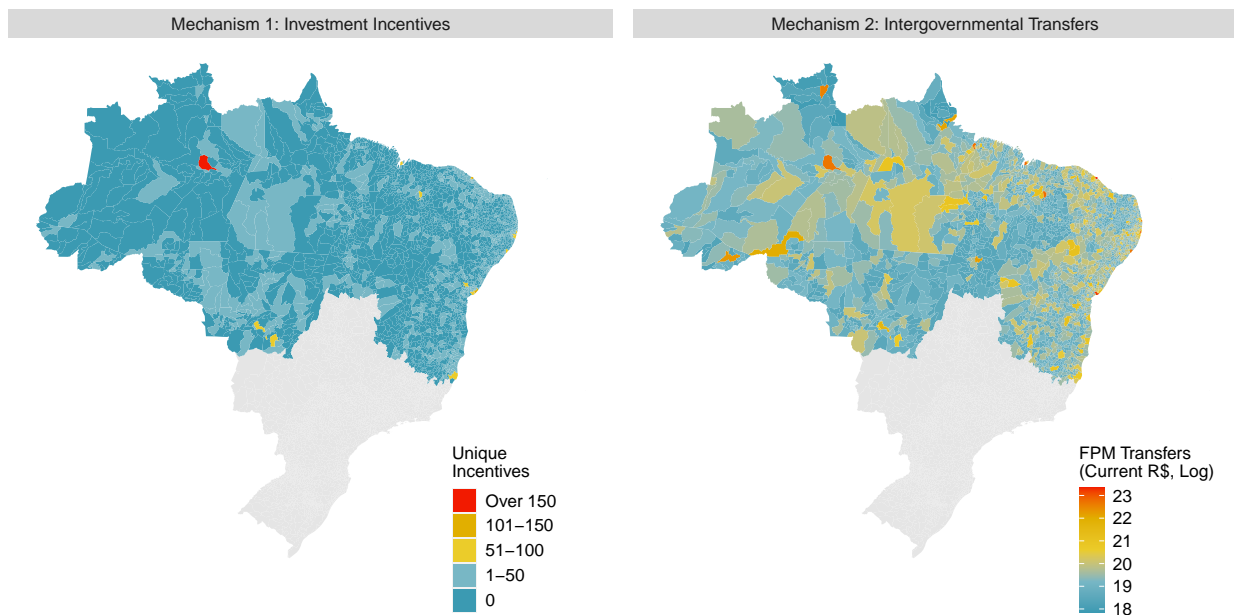
*Mayor Party Ideology* ranges from –1 (extreme left) to 1 (extreme right), and is based on data from Zucco and Power (2024).<sup>9</sup> We are agnostic about the effect of this variable on the outcome of interest, given the mixed evidence that rulers on the left (Pinto and Pinto 2008; Garriga 2022) or on the right (Arvate and Story 2021; Wang and Heyes 2021) are better able to signal a commitment to property rights protection – which, in turn, increases foreign investment.

*Mayoral Election* takes the value of 1 for years with mayoral elections (not only 2008, 2012, 2016, and 2020, but also the years of special elections, if applicable). Country-level studies indicate that

---

<sup>9</sup>While Power and Rodrigues-Silveira’s (2019) Municipal Ideology Score would be a better fit for our study, it is only available until 2018.

**Figure 2:** Distribution of Our Mechanisms in the Area Under SUDENE's and SUDAM's Jurisdictions, 2011–2021



FDI inflows drop in election years because of increased uncertainty (Julio and Yook 2016; Chen et al. 2019). If this finding applies to municipalities, we should expect a negative and statistically significant effect for *Mayoral Election*. *Mayor Second Term* takes the value of 1 for all mayors serving their second term – electoral rules in Brazil allow mayors to serve for only two full consecutive terms. Based again on the rationale of how investors perceive uncertainty, we should expect mayors serving for a second term to be associated with more FDI attraction, rendering the coefficient for *Mayor Second Term* positive and statistically significant.

#### 4.5 Models

Count dependent variables are often modelled using a Poisson model. This assumes that the counts follow a Poisson distribution, where the mean and the variance are equal. But *FDI Transaction Count* suffers from overdispersion: its variance (780.824) is considerably larger than its mean (0.834). A more suitable alternative, the negative binomial distribution, allows the variance to exceed the mean, providing greater flexibility in modeling overdispersed variables. The negative binomial model incorporates an additional parameter, the dispersion parameter, that accounts for unobserved heterogeneity or extra variability in the data.

Our data also exhibit a hierarchical structure: municipalities within the same state are likely more similar to each other than to municipalities from different states, and municipalities in one year are likely more similar to each other than to municipalities in other years. For this reason, we estimate multilevel negative binomial models with state and year random intercepts.<sup>10</sup> Random intercepts estimate a single variance parameter for the distribution of state-specific or year-specific intercepts. This captures unobserved differences between states, for example, which may be due to cultural, economic, or geographic factors that are difficult to quantify. By assuming that the state-specific intercepts are drawn from a common distribution, the model pools information across states, particularly for states with smaller sample sizes. This helps stabilize parameter estimates and improves the reliability of inference. Random intercepts are also more efficient than fixed effects;

<sup>10</sup>We also estimated models with random intercepts for each municipality and for the 510 immediate geographic regions (a group of municipalities with a shared urban center). However, these models did not converge, possibly due to the large number of units and the fact that municipality random intercepts are strongly correlated with other predictors.

including fixed effects for every state would result in a model with a large number of parameters, making interpretation more challenging.

## 5 Results

### 5.1 Testing H1: The Absolute Effects of Political Alignment

Table 2 presents evidence supporting Hypothesis 1. In this table, each coefficient indicates how a one-unit increase in the corresponding predictor variable affects the logged incidence rate of *FDI Transaction Count*. We exponentiate each coefficient to obtain its incidence rate ratio, which allows for an easier interpretation of effects. Politically aligned municipalities attract 12.8 percent more FDI transactions ( $e^{0.12} = 1.128$ ) than non-aligned municipalities, while holding all other variables constant at their mean (for continuous variables) or reference category (for dichotomous variables). This effect is positive and statistically significant ( $p < 0.001$ ). Put simply, a mayor is better equipped to attract FDI when their party votes with the president’s party in Congress.

Our political controls largely conform to expectations: FDI transactions decrease in years of mayoral election and increase during a mayor’s second term or after a mayor switches parties. The effect of party switching is consistent with the overarching idea that mayors switch parties to access more resources from the incumbent central government. We also find that right-wing mayors are associated with more FDI transactions, corroborating previous research in Brazil (Arvate and Story 2021).

Most regional factors also behave as expected. *GDP*, one indicator of agglomeration, has a positive and statistically significant effect, indicating that more agglomerated cities attract more FDI transactions; the same applies to *Population Density*. Our proxies for location advantages related to infrastructure, *Ports* and *Airports*, display positive and statistically significant effects, corroborating the expectation that investors tend to locate their operations in cities with good transportation networks. As for location advantages associated with labor supply, *STEM Workers* displays a statistically significant and positive coefficient, as expected; in contrast, the variable *Manufacturing Workers* goes against our expectations, with statistically significant negative effect. One possibility for this puzzling finding is that a large share of FDI transactions entering in Brazil in the period is unrelated to manufacturing, which is consistent with recent trends of deindustrialization in the country. Finally, *Economic Concentration HHI* indicates that, as expected, areas with less economic diversity attract less foreign capital.

### 5.2 Testing H2: The Conditional Effects of Political Alignment

Our second hypothesis posits that the effects of political alignment should be more pronounced for municipalities that are less attractive to investors. In other words, the effect of political alignment on FDI transactions should increase as (1) agglomeration and location advantages decrease; and as (2) concentration increases. To test these conditional relationships, we interact *Political Alignment* with our measures of agglomeration, location advantages, and concentration.

The results from these interactions yield mixed conclusions (Table 3). The coefficients of the interaction terms considering measures of agglomeration (*Population Density* and *GDP*) are statistically significant, but go against our expectations: non-aligned municipalities are associated with *more* FDI transactions than aligned ones across different levels of both population density and GDP. The same applies for *STEM Workers* and *Manufacturing Workers*; in contrast, the interaction terms for *Airports* and *Ports* are not statistically significant, indicating that there is no meaningful variation in the effects of political alignment across different levels of infrastructure. The political control variables remain robust relative to Table 2.

**Table 2:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Results From a Multilevel Negative Binomial Model With Random Intercepts for State and Year*

	FDI Transactions
	Model 1
Political Alignment, $t - 1$	0.12*** (0.03)
Mayor Party Switch, $t - 1$	0.14* (0.06)
Mayor Ideology, $t - 1$	0.10** (0.04)
Mayoral Election	-0.13 (0.16)
Mayor Second Term	0.10** (0.04)
GDP (Log)	0.87*** (0.02)
Population Density (Log)	0.18*** (0.01)
STEM Workers, % (Log)	0.84*** (0.05)
Manufacturing Workers, % (Log)	-0.24*** (0.02)
Airports	0.08* (0.04)
Ports	0.25*** (0.07)
Economic Concentration (HHI)	-1.10*** (0.14)
Intercept	-14.11*** (0.35)
AIC	38386.45
BIC	38529.56
Log Likelihood	-19177.22
Observations	56641
Number of States	26
Number of Years	11
Variance: States (Intercept)	0.89
Variance: Years (Intercept)	0.44

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$



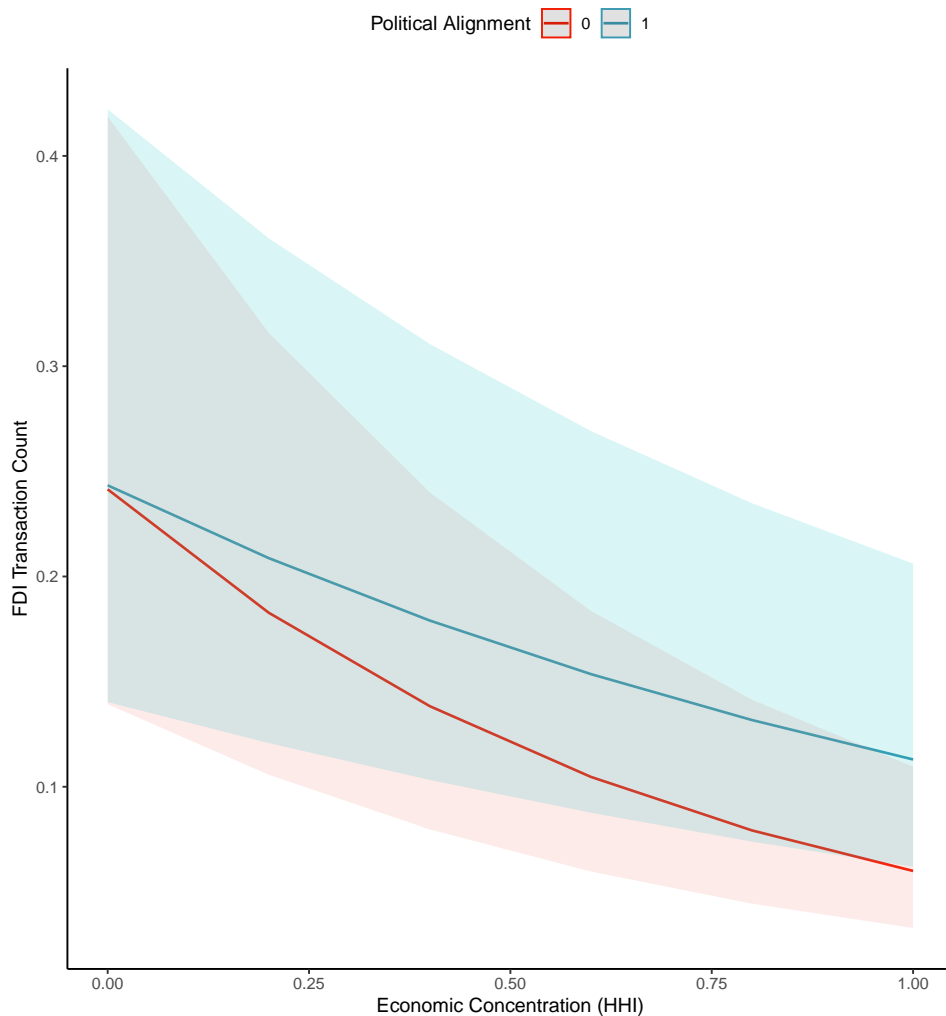
**Table 3:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Results From Multilevel Negative Binomial Models With Random Intercepts for State and Year*

	FDI Transactions						
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Political Alignment, $t - 1$	0.83*** (0.21)	0.51*** (0.08)	0.24*** (0.05)	0.45*** (0.07)	0.09* (0.04)	0.12*** (0.03)	0.01 (0.04)
Mayor Party Switch, $t - 1$	0.14* (0.06)	0.15* (0.06)	0.15* (0.06)	0.14* (0.06)	0.14* (0.06)	0.15* (0.06)	0.15* (0.06)
Mayor Ideology, $t - 1$	0.10** (0.04)	0.10** (0.04)	0.10** (0.04)	0.09* (0.04)	0.09* (0.04)	0.10** (0.04)	0.10** (0.04)
Mayoral Election	-0.13 (0.16)	-0.12 (0.16)	-0.14 (0.16)	-0.13 (0.16)	-0.13 (0.16)	-0.13 (0.16)	-0.13 (0.16)
Mayor Second Term	0.10** (0.04)	0.09* (0.04)	0.10** (0.04)	0.10** (0.04)	0.10** (0.04)	0.10** (0.04)	0.10** (0.04)
GDP (Log)	0.90*** (0.02)	0.87*** (0.02)	0.87*** (0.02)	0.87*** (0.02)	0.87*** (0.02)	0.87*** (0.02)	0.87*** (0.02)
Population Density (Log)	0.18*** (0.01)	0.22*** (0.02)	0.18*** (0.01)	0.18*** (0.01)	0.18*** (0.01)	0.18*** (0.01)	0.18*** (0.01)
STEM Workers, % (Log)	0.84*** (0.05)	0.84*** (0.05)	0.94*** (0.06)	0.84*** (0.05)	0.84*** (0.05)	0.84*** (0.05)	0.84*** (0.05)
Manufacturing Workers, % (Log)	-0.25*** (0.02)	-0.25*** (0.02)	-0.25*** (0.02)	-0.19*** (0.02)	-0.24*** (0.02)	-0.24*** (0.02)	-0.24*** (0.02)
Airports	0.08* (0.04)	0.08* (0.04)	0.08* (0.04)	0.08* (0.04)	0.03 (0.05)	0.08* (0.04)	0.08* (0.04)
Ports	0.25*** (0.07)	0.24*** (0.07)	0.25*** (0.07)	0.25*** (0.07)	0.25*** (0.07)	0.20* (0.09)	0.25*** (0.07)
Economic Concentration (HHI)	-1.09*** (0.14)	-1.09*** (0.14)	-1.09*** (0.14)	-1.11*** (0.14)	-1.10*** (0.14)	-1.10*** (0.14)	-1.39*** (0.16)
Political Alignment*GDP (Log)	-0.05*** (0.01)						
Political Alignment*Population Density (Log)		-0.08*** (0.02)					
Political Alignment*STEM Workers, % (Log)			-0.23** (0.07)				
Political Alignment*Manufacturing Workers, % (Log)				-0.13*** (0.02)			
Political Alignment*Airport					0.11 (0.06)		
Political Alignment*Port						0.11 (0.12)	
Political Alignment*Economic Concentration (HHI)							0.63*** (0.16)
Intercept	-14.45*** (0.37)	-14.30*** (0.36)	-14.18*** (0.36)	-14.25*** (0.36)	-14.09*** (0.35)	-14.11*** (0.35)	-14.05*** (0.35)
AIC	38376.66	38359.61	38378.38	38360.85	38385.06	38387.60	38373.12
BIC	38528.71	38511.67	38530.44	38512.90	38537.12	38539.65	38525.18
Log Likelihood	-19171.33	-19162.81	-19172.19	-19163.42	-19175.53	-19176.80	-19169.56
Observations	56641	56641	56641	56641	56641	56641	56641
Number of States	26	26	26	26	26	26	26
Number of Years	11	11	11	11	11	11	11
Variance: States (Intercept)	0.89	0.89	0.89	0.89	0.89	0.89	0.89
Variance: Year (Intercept)	0.44	0.44	0.44	0.44	0.44	0.44	0.44

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$

*Political Alignment* behaves as expected when conditioned on *Economic Concentration*. The interaction term shows a positive and statistically significant effect. Given how difficult it is to interpret interaction effects in tabular form, we plot the predicted count of FDI transactions across different values of *Economic Concentration*, as presented in Figure 3. As a reminder, smaller values indicate less concentrated/more diversified municipalities in terms of economic activities, a feature conducive to FDI attraction; larger values indicate more concentrated/less diversified municipalities, which tend to dissuade investment. When *Economic Concentration* is near zero, the effects of being aligned or non-aligned are indistinguishable. However, as *Economic Concentration* (*HHI*) increases, *Political Alignment* displays a positive and statistically significant effect.

**Figure 3:** Predicted Count of FDI Transactions conditional on different levels of Economic Concentration (*HHI*), Based on Model 7 of Table 3



Taken together, these results partially corroborate our second hypothesis. They indicate political alignment exhibits heterogeneous effects across at least one regional factor: economic concentration. Substantively, these results suggest that local politics might matter most for more concentrated, less dynamic municipalities interested in attracting FDI. Under certain conditions, political alignment may compensate for the lack of attractiveness of a concentrated, non-diverse municipality. In contrast, agglomeration levels and location advantages are so important for investors that a political factor such as alignment is unlikely to influence their decisions.

### 5.3 Testing the Mechanisms: Investment Incentives and Intergovernmental Transfers

Lastly, we examine the effect of the two proposed mechanisms by replicating Model 7 of Table 3, but including only *Investment Incentives* (Model 8), only *Intergovernmental Transfers* (Model 9), and both (Model 10). Now the sample shrinks to the 19 states that are partially or entirely under SUDAM or SUDENE jurisdiction, and the nine years (from 2013 to 2021) for which data on investment incentives are available.

Table 4 presents the results, which lend some support to the investment incentives mechanism at the expense of intergovernmental transfers. The coefficient for *Investment Incentives* is positive and statistically significant. Substantively, one additional investment incentive granted by SUDENE or SUDAM is associated with a 3 percent increase in the number of FDI transactions to a given municipality ( $e^{0.03} = 1.03$ ,  $p < 0.001$ ). In contrast, the coefficient for *Intergovernmental Transfers* is negative and statistically significant. That receiving more of the revenue-sharing grant FPM is associated with less FDI attraction goes against our expectations, as we predicted a null effect for this mechanism, given the time it takes for transfers to turn into public goods that investors usually value. We are unable to test the effects of investment incentives across the whole country due to the lack of data for states outside the jurisdiction of SUDAM or SUDENE. But FPM data are available for all of Brazil; when we examine the effects of intergovernmental transfers for the entire country, we confirm the negative, statistically significant effect of this variable on FDI attraction.<sup>11</sup> This puzzling effect suggests that this variable may be picking up the effect of another mechanism, a possibility we leave for future research to investigate.

We also note that the inclusion of our mechanisms' variables renders the coefficient for *Political Alignment* negative. However, we are more interested in the interaction effects between this variable and *Economic Concentration (HHI)*; reassuringly, the interaction term remains positive and statistically significant. Another way to look at our results is to highlight the positive effect of investment incentives on FDI attraction at the municipality level, in the presence of several other controls. Although substantively small, this effect is consistent with literature showing that incentives may contribute to FDI attraction in the developing world (Klemm and Parys 2012; Baccini et al. 2014).

## 6 Next Steps

In future iterations of this paper, we plan to further examine the mechanisms through which political alignment promotes FDI. We ran mediation analyses to examine whether the effect of political alignment on FDI attraction happens through investment incentives and intergovernmental transfers, but the models did not confirm this expectation. One possibility is that the data employed to operationalize our mechanisms is currently too noisy. In particular, the data from SUDAM and SUDENE include investment incentives granted to both domestic and foreign firms. One obvious next step is to disentangle those two types of incentives. Another possibility is to explore an extensive dataset about investment incentives at the firm level that is gradually being released by the Federal Revenue Service since May 2023.

Moreover, we intend to improve the measurement of our key variables. We have been discussing strategies with Apex-Brasil to obtain data on the *value* — not just the *count* — of FDI Transactions to Brazilian municipalities. Our current strategy of using the count of FDI transactions registered by the Central Bank is likely a good proxy for FDI activity, and it is already an improvement over other sources that cannot fully disentangle announced and effective FDI projects, such as *fDi Markets*. Nonetheless, obtaining the value of each of our effective FDI transactions will allow for

---

<sup>11</sup>Results available upon request.

**Table 4:** *The Effect of Investment Incentives and Intergovernmental Transfers on FDI Transactions, 2011–2021. Results From Multilevel Negative Binomial Models With Random Intercepts for State and Year*

	FDI Transactions		
	Model 8	Model 9	Model 10
Political Alignment, $t - 1$	−0.23*	−0.25**	−0.24**
	(0.09)	(0.09)	(0.09)
Mayor Party Switch, $t - 1$	0.26**	0.26**	0.25*
	(0.10)	(0.10)	(0.10)
Mayor Ideology, $t - 1$	0.12	0.11	0.10
	(0.06)	(0.06)	(0.06)
Mayoral Election	−0.39	−0.40	−0.39
	(0.26)	(0.26)	(0.26)
Mayor Second Term	0.17**	0.18**	0.17**
	(0.06)	(0.06)	(0.06)
GDP (Log)	0.67***	0.84***	0.81***
	(0.03)	(0.04)	(0.05)
Population Density (Log)	0.04*	0.10***	0.09***
	(0.02)	(0.02)	(0.02)
STEM Workers, % (Log)	0.52***	0.49***	0.47***
	(0.09)	(0.09)	(0.09)
Manufacturing Workers, % (Log)	−0.46***	−0.47***	−0.47***
	(0.03)	(0.03)	(0.03)
Airports	0.22**	0.31***	0.33***
	(0.07)	(0.07)	(0.07)
Ports	0.68***	0.86***	0.76***
	(0.12)	(0.12)	(0.12)
Economic Concentration (HHI)	−3.08***	−2.86***	−2.93***
	(0.22)	(0.22)	(0.22)
Political Alignment*Economic Concentration (HHI)	1.06***	1.08***	1.07***
	(0.23)	(0.23)	(0.23)
Investment Incentives	0.03***		0.03***
	(0.01)		(0.01)
Intergovernmental Transfers (Log)		−0.31***	−0.32***
		(0.08)	(0.07)
Intercept	−9.92***	−7.10***	−6.61***
	(0.52)	(0.92)	(0.92)
AIC	13037.43	13042.26	13021.40
BIC	13181.27	13186.10	13173.23
Log Likelihood	−6500.71	−6503.13	−6491.70
Observations	21831	21831	21831
Number of States	19	19	19
Number of Years	9	9	9
Variance: States (Intercept)	1.26	1.19	1.23
Variance: Years (Intercept)	0.29	0.27	0.25

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$

more variation and the possibility of testing other model specifications. We also plan to generate an indicator of political alignment between elected mayors and state governors, based on a similar methodology to the one we already use, and to include controls for electoral competition at the local level. All these data are publicly available.

## 7 Conclusion

This study sheds light on how local politics affects subnational FDI allocation. While previous scholarship has primarily focused on the effects of partisanship and ideology in determining the site of investment projects within a given country, our research examines the impact of political alignment in attracting foreign capital transactions at the host municipality level.

Using novel data on FDI transactions that entered Brazilian municipalities between 2011 and 2021, our findings reveal that political alignment – operationalized as the situation in which the mayor’s party is a member of the president’s support coalition in Congress – has a positive effect on FDI allocation. Furthermore, the study highlights the importance of considering the effects of regional factors on FDI. As economic activity concentration increases, indicating less dynamic municipalities, the effect of political alignment becomes more pronounced. In other words, political alignment is likely an important factor to bring FDI to less attractive areas to foreign investors in the first place. We also entertain the possibility of two mechanisms that could mediate the relationship between political alignment and FDI attraction: investment incentives and intergovernmental transfers. We do not find decisive evidence on this matter, but there is indication that investment incentives can at least partially explain the relationship we observe.

As municipalities increasingly become central to national economic strategies (OECD 2022), it is imperative that central governments know what the best policies to help their subnational units achieve growth and development are. This is particularly relevant for large, middle-income, unequal countries like Brazil, Mexico, South Africa, and Indonesia, among others. These countries attract large amounts of FDI (UNCTAD 2022), but face several fiscal challenges, such that redistributive policies become very consequential. Of course, even if we come to learn what the best policies for attracting and distributing FDI activity within a given country are, we cannot disregard the incentives that politicians will continue to have to seek for alignment and the potential negative consequences this may bring, such as corruption and clientelism.

More broadly, our research underscores the heterogeneity of the effects of global economic integration within a single country and emphasizes the conditional nature of political factors in explaining such variation. Globalization provokes varied effects within a given country; such variation is partly explained by permanent characteristics related to local economic, social, and geographic aspects, and by political factors, which tend to be more dynamic. Understanding how these two classes of factors interact to produce different outcomes is crucial in a world where the local dimension becomes increasingly intertwined with the global one (Baccini and Weymouth 2021; Broz et al. 2021; Fraccaroli et al. 2023).

## References

- Alberti, C., Díaz-Rioseco, D., and Visconti, G. (2022). Can political alignment reduce crime? Evidence from Chile. *Political Science Research and Methods*, 11(2):223–236.
- Ames, B. (2002). *The Deadlock of Democracy in Brazil*. University of Michigan Press, Michigan.
- Anselin, L., Varga, A., and Acs, Z. (1997). Local geographic spillovers between university research and high technology innovations. *Journal of Urban Economics*, 42(3):422–448.



- Arulampalam, W., Dasgupta, S., Dhillon, A., and Dutta, B. (2009). Electoral goals and center-state transfers: A theoretical model and empirical evidence from India. *Journal of Development Economics*, 88(1):103–119.
- Arvate, P. and Story, J. (2021). Leaders affect business creation: Evidence from mayoral elections. *The Leadership Quarterly*, page 101577.
- Ascani, A. and Gagliardi, L. (2020). Asymmetric spillover effects from mne investment. *Journal of World Business*, 55(6):101146.
- Baccini, L., Li, Q., and Mirkina, I. (2014). Corporate Tax Cuts and Foreign Direct Investment. *Journal of Policy Analysis and Management*, 33(4):977–1006.
- Baccini, L., Li, Q., Mirkina, I., and Johnson, K. (2018). Regional competition, business politicians, and subnational fiscal policy. *Business and Politics*, 20(3):410–437.
- Baccini, L. and Weymouth, S. (2021). Gone for Good: Deindustrialization, White Voter Backlash, and US Presidential Voting. *American Political Science Review*, 115:550–567.
- Ballard-Rosa, C., Malik, M. A., Rickard, S. J., and Scheve, K. (2021). *The Economic Origins of Authoritarian Values: Evidence From Local Trade Shocks in the United Kingdom*, volume 0.
- Barry, C. M. (2018). Peace and conflict at different stages of the fdi lifecycle. *Review of International Political Economy*, 25(2):270–292.
- Bauerle Danzman, S. and Meunier, S. (2023). Mapping the Characteristics of Foreign Investment Screening Mechanisms: The New PRISM Dataset. *International Studies Quarterly*, 67(2).
- Bauerle Danzman, S. and Slaski, A. (2022). Incentivizing embedded investment: Evidence from patterns of foreign direct investment in Latin America. *The Review of International Organizations*, 17(1):63–87.
- Beaudry, C. and Schiffauerova, A. (2009). Who’s right, marshall or jacobs? the localization versus urbanization debate. *Research Policy*, 38(2):318–337.
- Belderbos, R., Du, H. S., and Slangen, A. (2020). When do firms choose global cities as foreign investment locations within countries? the roles of contextual distance, knowledge intensity, and target-country experience. *Journal of World Business*, 55(1):101022.
- Berry, C. R., Burden, B. C., and Howell, W. G. (2010). The President and the Distribution of Federal Spending. *American Political Science Review*, 104(4):783–799.
- Blanton, S. L. and Blanton, R. G. (2007). What Attracts Foreign Investors? An Examination of Human Rights and Foreign Direct Investment. *Journal of Politics*, 69(1):143–155.
- Bresslein, M., Cieslik, A., and Matschke, X. (2019). Vertical Industry Linkages and the Location of Foreign Direct Investment in Poland. *Eastern European Economics*, 57(6):457–483.
- Brollo, F. and Nannicini, T. (2012). Tying Your Enemy’s Hands in Close Races: The Politics of Federal Transfers in Brazil. *American Political Science Review*, 106(4):742–761.
- Brollo, F., Nannicini, T., Perotti, R., and Tabellini, G. (2013). The Political Resource Curse. *American Economic Review*, 103(5):1759–1796.
- Broz, J. L., Frieden, J., and Weymouth, S. (2021). Populism in Place: The Economic Geography of the Globalization Backlash. *International Organization*, 75(2):464–494.

- Bunte, J. B., Desai, H., Gbala, K., Parks, B., and Runfola, D. M. (2018). Natural resource sector FDI, government policy, and economic growth: Quasi-experimental evidence from Liberia. *World Development*, 107:151–162.
- Caesar, G. (2018). Saiba como eram e como ficaram as bancadas na câmara dos deputados, partido a partido. *G1*. Available at: <https://g1.globo.com/politica/eleicoes/2018/eleicao-em-numeros/noticia/2018/10/08/pt-perde-deputados-mas-ainda-tem-maior-bancada-da-camara-psl-de-bolsonaro-ganha-52-representantes.ghtml> Accessed: June 13th, 2023.
- Chen, K., Nie, H., and Ge, Z. (2019). Policy uncertainty and fdi: Evidence from national elections. *The Journal of International Trade & Economic Development*, 28(4):419–428.
- Cohen, W. M. and Levinthal, D. A. (1990). Absorptive capacity: A new perspective on learning and innovation. *Administrative Science Quarterly*, 35(1):128–152.
- Cohen, W. M., Nelson, R. R., and Walsh, J. P. (2002). Links and impacts: The influence of public research on industrial r&d. *Management Science*, 48(1):1–23.
- Crescenzi, R., Iammarino, S., Ioramashvili, C., Rodríguez-Pose, A., and Storper, M. (2019). The geography of innovation: Local hotspots and global innovation networks. *Economic Research Working Paper Series*, (57).
- Crespo, N. and Fontoura, M. P. (2007). Determinant factors of fdi spillovers – what do we really know? *World Development*, 35(3):410–425.
- Cruz, C., Keefer, P., and Scartascini, C. (2021). *Database of Political Institutions 2020*. Inter-American Development Bank Research Department, Washington, DC.
- Desposato, S. W. (2006). Parties for Rent? Ambition, Ideology, and Party Switching in Brazil’s Chamber of Deputies. *American Journal of Political Science*, 50(1):62–80.
- Duranton, G. and Puga, D. (2001). Nursery cities: Urban diversity, process innovation, and the life cycle of products. *American Economic Review*, 91(5):1454–1477.
- Elkins, Z., Guzman, A. T., and Simmons, B. A. (2006). Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000. *International Organization*, 60(4):811–846.
- Escobar Gamboa, O. R. (2012). FDI determinants and spatial spillovers across Mexico’s states. *The Journal of International Trade and Economic Development*.
- Feldman, M. P. and Audretsch, D. B. (1999). Innovation in cities:: Science-based diversity, specialization and localized competition. *European Economic Review*, 43(2):409–429.
- Ferraz, A. (2023). Psdb enfrenta debandada de prefeitos em sp; ala nacional planeja ‘intervenção’ para conter crise. *Estadão*. Available at: <https://www.estadao.com.br/politica/psdb-enfrenta-debandada-de-prefeitos-em-sp-ala-nacional-planeja-intervencao-para-conter-crise/> Accessed: June 13th, 2023.
- Fracaroli, N., Regan, A., and Blyth, M. (2023). Brexit and the ties that bind: how global finance shapes city-level growth models. *Journal of European Public Policy*, pages 1–26.
- Gadenne, L. (2017). Tax Me, but Spend Wisely? Sources of Public Finance and Government Accountability. *American Economic Journal: Applied Economics*, 9(1):274–314.
- Garriga, A. C. (2022). International Capital and Subnational Politics: Partisanship and Foreign Direct Investment in Mexican States. *Political Research Quarterly*, 75(4):1006–1020.

- Garriga, A. C. and Phillips, B. J. (2022). Organized Crime and Foreign Direct Investment: Evidence From Criminal Groups in Mexico. *Journal of Conflict Resolution*, page 002200272211458.
- Garsous, G., Corderi, D., Velasco, M., and Colombo, A. (2017). Tax Incentives and Job Creation in the Tourism Sector of Brazil's SUDENE Area. *World Development*, 96:87–101.
- Glaeser, E. L., Kallal, H. D., Scheinkman, J. A., and Shleifer, A. (1992). Growth in cities. *Journal of Political Economy*, 100(6):97–115.
- Ha, H. and Jenkins, J. A. (2024). Do presidents favor co-partisan mayors in the allocation of federal grants? *Political Science Research and Methods*, Online First:1–10.
- Halvorsen, T. and Jakobsen, J. (2013). Democrats, Republicans—or Both? An Empirical Analysis of the Effects of the Composition of State Governments on FDI, 1977–2004. *International Interactions*, 39(2):167–191.
- Horsth, T. A., Almeida, F. M. d., and Mendes, W. d. A. (2021). Medidas institucionais e econômicas do PAC: A recriação da Sudam e da Sudene e o desenvolvimento regional. *Latin American Research Review*, 56(1):98–112.
- Jensen, N. M. (2003). Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment. *International Organization*, 57(3):587–616.
- Jensen, N. M. (2012). Fiscal Policy and the Firm: Do Low Corporate Tax Rates Attract Multinational Corporations? *Comparative Political Studies*, 45(8):1004–1026.
- Jensen, N. M. and Malesky, E. J. (2018). *Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain*. Cambridge University Press, Cambridge.
- Jensen, N. M. and Rosas, G. (2007). Foreign Direct Investment and Income Inequality in Mexico, 1990–2000. *International Organization*, 61:467–487.
- Jud, S. (2023). Beyond pandering: Investment project quality, voter support, and the use of investment incentives. *Business and Politics*, 25(4):429–449.
- Julio, B. and Yook, Y. (2016). Policy uncertainty, irreversibility, and cross-border flows of capital. *Journal of International Economics*, 103:13–26.
- Klemm, A. and Parys, S. V. (2012). Empirical evidence on the effects of tax incentives. *International Tax and Public Finance*, 19(3):393–423.
- Knoben, J. (2009). Localized inter-organizational linkages, agglomeration effects, and the innovative performance of firms. *The Annals of Regional Science*, 43:757–779.
- Li, Q. (2006). Democracy, autocracy, and tax incentives to foreign direct investors: A cross-national analysis. *Journal of Politics*, 68:62–74.
- Li, Q. and Resnick, A. (2003). Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries. *International Organization*, 57(1):175–211.
- Litschig, S. (2012). Are rules-based government programs shielded from special-interest politics? Evidence from revenue-sharing transfers in Brazil. *Journal of Public Economics*, 96(11-12):1047–1060.
- Litschig, S. and Morrison, K. M. (2013). The Impact of Intergovernmental Transfers on Education Outcomes and Poverty Reduction. *American Economic Journal: Applied Economics*, 5(4):206–240.

- Lu, K. L. and Biglaiser, G. (2020). The Politics of Chinese Foreign Direct Investment in the USA. *Journal of Asian and African Studies*, 55(2):254–272.
- Maitland, E. and Sammartino, A. (2015). Managerial cognition and internationalization. *Journal of International Business Studies*, 46:733–760.
- Mataloni Jr, R. J. (2011). The structure of location choice for new us manufacturing investments in asia-pacific. *Journal of World Business*, 46(2):154–165.
- McMillan, S. L. (2009). Looking Beyond the National Level: Foreign Direct Investment Attraction in U.S. States. *International Interactions*, 35(2):155–178.
- Meireles, F. (2018). Alinhamento partidário e demanda por transferências federais no Brasil. *Revista de Administração Pública*, 53(1):173–194.
- Migueis, M. (2013). The Effect of Political Alignment on Transfers to Portuguese Municipalities. *Economics & Politics*, 25(1):110–133.
- Miguélez, E. and Moreno, R. (2015). Knowledge flows and the absorptive capacity of regions. *Research Policy*, 44(4):833–848.
- Moehlecke, C. and Wellhausen, R. L. (2022). Political Risk and International Investment Law. *Annual Review of Political Science*, 25(1):485–507.
- Morales, H. F. and Moreno, R. (2020). Fdi productivity spillovers and absorptive capacity in brazilian firms: A threshold regression analysis. *International Review of Economics & Finance*, 70:257–272.
- OECD (2022). *Africa's Urbanisation Dynamics 2022*.
- Oman, C. P. (2000). Policy Competition for Foreign Direct Investment. *Development Centre Studies*.
- Owen, E. (2019). Foreign Direct Investment and Elections: The Impact of Greenfield FDI on Incumbent Party Reelection in Brazil. *Comparative Political Studies*, 52(4):613–645.
- Pandya, S. S. (2014). *Trading Spaces*. Cambridge University Press, New York, NY.
- Pandya, S. S. (2016). Political Economy of Foreign Direct Investment: Globalized Production in the Twenty-First Century. *Annual Review of Political Science*, 19(1):455–475.
- Pinto, P. M. (2013). *Partisan Investment in the Global Economy*. Cambridge University Press, Cambridge.
- Pinto, P. M. and Pinto, S. M. (2008). The Politics of Investment Partisanship: and the Sectoral Allocation of Foreign Direct Investment. *Economics & Politics*, 20(2):216–254.
- Power, T. J. and Rodrigues-Silveira, R. (2019). Mapping Ideological Preferences in Brazilian Elections, 1994-2018: A Municipal-Level Study. *Brazilian Political Science Review*, 13(1):e0001.
- Rickard, S. J. (2020). Economic Geography, Politics, and Policy. *Annual Review of Political Science*, 23(1):182–202.
- Rickard, S. J. (2022). Economic Geography, Politics, and the World Trade Regime. *World Trade Review*, 21(3):367–379.
- Rodríguez-Pose, A. and Crescenzi, R. (2008). Mountains in a flat world: why proximity still matters for the location of economic activity. *Cambridge Journal of Regions, Economy and Society*, 1(3):371–388.

- Samford, S. and Gómez, P. O. (2014). Subnational politics and foreign direct investment in Mexico. *Review of International Political Economy*, 21(2):467–496.
- Samuels, D. and Zucco, C. (2014). The power of partisanship in Brazil: Evidence from survey experiments. *American Journal of Political Science*, 58:212–225.
- Simmons, J., Hicken, A., Kollman, K., and Nooruddin, I. (2018). Party system structure and its consequences for foreign direct investment. *Party Politics*, 24(2):141–153.
- Storper, M. and Venables, A. J. (2004). Buzz: face-to-face contact and the urban economy. *Journal of Economic Geography*, 4(4):351–370.
- Sugiyama, N. B. and Hunter, W. (2013). Whither Clientelism? Good Governance and Brazil's "Bolsa Família" Program. *Comparative Politics*, 46(1):43–62.
- UNCTAD (2022). *World Investment Report 2022 - International Tax Reforms and Sustainable Investment*.
- Wang, K. and Heyes, A. (2021). Does the party in power affect FDI? First causal evidence from narrow margin US state elections. *Party Politics*, 28(5):797–810.
- Wang, Y., Ning, L., Li, J., and Prevezer, M. (2016). Foreign direct investment spillovers and the geography of innovation in Chinese regions: The role of regional industrial specialization and diversity. *Regional Studies*, 50(5):805–822.
- Weymouth, S. and Broz, J. L. (2013). Government Partisanship and Property Rights: Cross-Country Firm-Level Evidence. *Economics & Politics*, 25(2):229–256.
- Zhu, B. and Shi, W. (2019). Greasing the Wheels of Commerce? Corruption and Foreign Investment. *Journal of Politics*, 81:1311–1327.
- Zucco, C. and Power, T. J. (2024). The Ideology of Brazilian Parties and Presidents: A Research Note on Coalitional Presidentialism Under Stress. *Latin American Politics and Society*, Online First:1–11.



# Appendix

## A Robustness: Different Lags of Political Alignment

**Table A.1:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Models With Different Lags of Political Alignment*

	FDI Transactions	
	Model 1	Model 2
Political Alignment, $t$	0.07*	
	(0.03)	
Political Alignment, $t - 2$		0.09**
		(0.03)
Mayor Party Switch, $t - 1$	0.14*	0.14*
	(0.06)	(0.07)
Mayor Ideology, $t - 1$	0.10**	0.11**
	(0.04)	(0.04)
Mayoral Election	-0.13	-0.11
	(0.16)	(0.16)
Mayor Second Term	0.10**	0.10**
	(0.04)	(0.04)
GDP (Log)	0.87***	0.87***
	(0.02)	(0.02)
Population Density (Log)	0.18***	0.18***
	(0.01)	(0.01)
STEM Workers, % (Log)	0.84***	0.85***
	(0.05)	(0.05)
Manufacturing Workers, % (Log)	-0.24***	-0.25***
	(0.02)	(0.02)
Airports	0.08*	0.08*
	(0.04)	(0.04)
Ports	0.25***	0.26***
	(0.07)	(0.07)
Economic Concentration (HHI)	-1.10***	-1.16***
	(0.14)	(0.14)
Intercept	-14.08***	-13.93***
	(0.35)	(0.36)
AIC	38395.47	36615.96
BIC	38538.58	36757.51
Log Likelihood	-19181.74	-18291.98
Observations	56641	51387
Number of States	26	26
Number of Years	11	10
Variance Component: States	0.89	0.88
Variance Component: Years	0.43	0.41

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$

The main models lag *Political Alignment* at  $t - 1$ . Table A.1 presents two models with this variable at times  $t$  and  $t - 2$ , respectively, indicating that our results are robust to these changes.

## B Robustness: Alternative Measures of Political Alignment

**Table B.1:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Models With Alternative Measures of Political Alignment*

	FDI Transactions		
	Model 1	Model 2	Model 3
Mayor and President Same Party, $t - 1$	-0.03 (0.04)		
Political Alignment 80%, $t - 1$		0.07* (0.03)	
Political Alignment 70%, $t - 1$			0.10** (0.03)
Mayor Party Switch, $t - 1$	0.14* (0.06)	0.14* (0.06)	0.14* (0.06)
Mayor Ideology, $t - 1$	0.10** (0.04)	0.11** (0.04)	0.10** (0.04)
Mayoral Election	-0.12 (0.16)	-0.13 (0.16)	-0.13 (0.16)
Mayor Second Term	0.10** (0.04)	0.10** (0.04)	0.10** (0.04)
GDP (Log)	0.87*** (0.02)	0.87*** (0.02)	0.87*** (0.02)
Population Density (Log)	0.18*** (0.01)	0.18*** (0.01)	0.18*** (0.01)
STEM Workers, % (Log)	0.84*** (0.05)	0.84*** (0.05)	0.84*** (0.05)
Manufacturing Workers, % (Log)	-0.24*** (0.02)	-0.24*** (0.02)	-0.24*** (0.02)
Airports	0.08* (0.04)	0.08* (0.04)	0.08* (0.04)
Ports	0.24*** (0.07)	0.24*** (0.07)	0.25*** (0.07)
Economic Concentration (HHI)	-1.09*** (0.14)	-1.09*** (0.14)	-1.09*** (0.14)
Intercept	-14.06*** (0.35)	-14.10*** (0.35)	-14.13*** (0.35)
AIC	38399.56	38395.33	38389.35
BIC	38542.67	38538.44	38532.46
Log Likelihood	-19183.78	-19181.66	-19178.67
Observations	56641	56641	56641
Number of States	26	26	26
Number of Years	11	11	11
Variance Component: States	0.89	0.89	0.88
Variance Component: Years	0.42	0.43	0.43

\*\*\* $p < 0.001$ ; \*\* $p < 0.01$ ; \* $p < 0.05$

To generate *Political Alignment*, the main models consider that a party is a member of the president's support coalition if the voting recommendation issued by its leadership aligns with the voting recommendation of the president's party at least 90 percent of the time. In Table B.1, Model 1 uses a narrower definition of alignment that only takes the value of 1 if the mayor and the president belong to the same party. Models 2 and 3 construct *Political Alignment* using less strict alignment thresholds (80 and 70 percent, respectively).

## C Robustness: Controlling for Diseconomies of Scale

**Table C.1:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Model Including the Municipal Homicide Rate*

	FDI Transactions
	Model 1
Political Alignment, $t - 1$	0.15*** (0.04)
Mayor Party Switch, $t - 1$	0.05 (0.07)
Mayor Ideology, $t - 1$	0.09* (0.04)
Mayoral Election	-0.09 (0.17)
Mayor Second Term	0.12** (0.04)
GDP (Log)	0.86*** (0.02)
Population Density (Log)	0.16*** (0.01)
STEM Workers, % (Log)	0.86*** (0.05)
Manufacturing Workers, % (Log)	-0.28*** (0.02)
Airports	0.04 (0.04)
Ports	0.20** (0.07)
Economic Concentration (HHI)	-1.76*** (0.16)
Homicides per 100k Inhabitants	0.02 (0.02)
Intercept	-13.75*** (0.38)
AIC	33639.37
BIC	33785.19
Log Likelihood	-16802.69
Observations	39249
Number of States	26
Number of Years	11
Variance Component: States	0.84
Variance Component: Years	0.46

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$

Table C.1 includes a measure of “diseconomies of scale:” the municipality’s homicide rate (out of 100,000), reported by the Institute of Applied Economic Research (IPEA). We do not include this variable in the main analysis due to a large number of missing observations for small municipalities.

## D Robustness Check: Alternative Dependent Variable

**Table D.1:** *The Effect of Political Alignment on FDI Transactions, 2011–2021. Model With a Dichotomous Measure of FDI Transactions*

	FDI Transactions – Binary
	Model 1
Political Alignment, $t - 1$	0.08 (0.05)
Mayor Party Switch, $t - 1$	0.01 (0.10)
Mayor Ideology, $t - 1$	0.08 (0.06)
Mayoral Election	0.18 (0.21)
Mayor Second Term	0.05 (0.06)
GDP (Log)	0.86*** (0.03)
Population Density (Log)	0.21*** (0.02)
STEM Workers, % (Log)	0.88*** (0.08)
Manufacturing Workers, % (Log)	-0.10*** (0.03)
Airports	0.11* (0.06)
Ports	0.56*** (0.12)
Economic Concentration (HHI)	-0.97*** (0.23)
Intercept	-15.02*** (0.41)
AIC	16763.52
BIC	16897.69
Log Likelihood	-8366.76
Observations	56641
Number of States	26
Number of Years	11
Variance Component: States	0.42
Variance Component: Years	0.26

\*\*\*  $p < 0.001$ ; \*\*  $p < 0.01$ ; \*  $p < 0.05$

Finally, Table D.1 replaces *FDI Transaction Count* with a binary measure indicating whether a municipality received any transaction. In the resulting model (a multilevel logit, rather than a multilevel negative binomial model), *Political Alignment* has a positive effect on the outcome, but this effect is not statistically significant and nor is the effect of any political variable. This indicates that political factors alone cannot explain whether a municipality attracts FDI or not, but they can explain *how much* FDI a municipality has the potential to attract.