Summary Readings – Political Economy FS2018

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Included in this summary is:

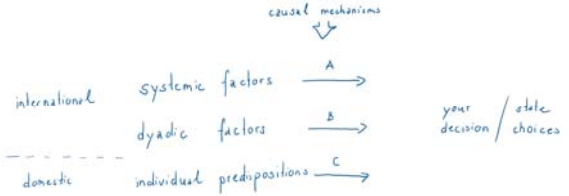
	Liberman (1996): Trading with the Enemy: Security and Relative Economic Gains.
RQ	– Wants to understand the relationship btw. security & economic cooperation – Should countries care more about relative gains in multipolar or bipolar systems? – Would relative economic gain argument work in today's multipolar int. system?
Arg	Relative-gains under multipolarity argument: Under multipolarity, states are less concerned with relative gains for two reasons: 1. multipolarity introduces collective action problems. → Great powers in multipolar systems can try to shift security burdens to their allies (not possible under bipolarity) 2. under multipolarity, rivalries and alliances can change over time. → Shortened duration of rivalries makes that great powers are less concerned by rivals' gains (as opposed to under bipolarity) In addition, relative economic gains are likely to be fairly even, particularly among the nations most likely to care about them. When gaps in relative gain are small → relative power shifts slowly → increasing the significance of threat duration and of system structure for relative gains sensitivity Thus, the security implications of relative economic gains should be low in multipolar systems, even among rivals. Under these conditions, policymakers will tend to focus on prosperity or political objectives in formulating trade policy. A state's sensitivity to relative gains depends on the degree and duration of the security threat posed by specific economic partners → this sensitivity is attenuated in multipolar int. systems and when defense is dominant. Gaps in gains from trade differ from gaps in military gains.
RD	– Two historical case studies – Secondary literature (policy regulations) and trade data from DE/JP and US/JP before WWII – He examines trade relations btw US & GB and btw the US & JP. → Selected these cases because at least one side in each case perceived both military danger and adverse asymmetric gains. = are fairly easy tests for the relative-gains argument, (easy case / most likely). If relative-gains argument works in these cases, it always will. (expectation: if relative gains works, there should be trade barriers because realism says countries are scared of others' power). – Measurement: imports + exports and policy statements by officials (their motives and calculations) – Why this method: The case-study method is useful because perceptions of threat and of relative gain are most accurately measured by qualitative assessments. Tracing officials' reported motives and calculations also helps to identify alternative explanations, including idiosyncratic ones that might affect generalizability of the findings.

R	Countries kept trading → under multipolarity security ramifications of relative gains are reduced. Further tests are needed to check the conditions under which great powers limit trade or other types of economic cooperation to prevent shifts in relative power.
L	External validity: In this particular case, security arguments might have been important (at the edge of war). Only two cases, specific time period.
!	– Study relates to realism – Whether states resist adverse (negative) relative gains for security reasons is also important to the theoretical debate between neorealists and neoliberals about the sources of international cooperation: o Neo*liberal:* states pursue absolute gains → supports idea that that information-providing and issue-linking institutions significantly heighten int. cooperation o Neo*realist:* sensitivity to relative gains intensifies distributional conflicts and cannot be easily addressed by int. institutions Relative-gains theory (realism): The theory can tell us when states should be more or less sensitive to relative gains. The sensitivity of relative gains is influenced by: - the political-military relationship between the nations involved, - the balance between offense and defense, and - the system polarity (structure). Relative sensitivity should be reduced by: (relative sensitivity should be heightened by) - low probability of war, (high probability of war) - defense dominance, (offence dominance) - multipolarity (bi-polarity) The theory cannot provide the empirical references necessary to determine the real significance of relative gains.

	Reuveny and Thompson (2008): Uneven Economic Growth and the World Economy's North–South Stratification.
RQ	Do system-leaders'* technological change and aggregate growth contribute equally to Northern and Southern economic growth? Is it likely that these forces primarily diffuse to the North and much less to the south?
Arg	Descriptive argument of uneven technological diffusion Marx's dependentia theory: the North has locked the South into a dependency structural, technologies don't diffuse to the South Liberals would argue: Accelerating growth in the South will eventually catch up with slowing growth in the North → elimination of gap H: Northern economies are the primary beneficiaries of the radical technological innovation while much less trickles down to the South.
RD	Descriptive analysis. 8 regression models in the end but actually descriptive. Time series data dating back to 1870 (aggregates + estimates) <u>Dependent variables:</u> aggregated national GDP into northern and southern groups. economic growth rates (GDP) (northern eco. growth & southern eco. growth) <u>Explanatory variables:</u> technological change in the leading economy (leading sector growth rate, leading sector share, systemic leadership, leader growth share) Unconventional setup: normally economic growth model would have the country (panel) as unit of observation but here different! **Unit of observation = the year!** → very noisy variable
R	North and South are not converging / Technologies don't diffuse to the South → Technological gains

	in the North have been more likely to expand the North-South gap than to close it. The diffusion of ideas, technologies, and know-how associated with the leading economy are likely to prosper better in the North than in the South. Support of view that emphasizes the leader's stronger economic ties with the North vis-à-vis the South
L	– Maybe it is not really a dependencia-marxist argument. The authors run a regression and find correlations but still don't find an answer for the dependencia argument / don't deliver the argument. – Simply aggregation over countries / nations → bad internal validity. Grouping of countries can be difficult, because only systemic level, they completely ignored the domestic levels. – Not very significant, findings are overblown – Shaky/unclear causal mechanism: technological development in CH will not affect Ivory Coast – Unit of observation = the year! → very noisy variable
!	Relates to Marx' dependentia theory (Marxism) **Dependentia theory:** Resources flow from a "periphery" of poor and underdeveloped states to a "core" of wealthy states, enriching the latter at the expense of the former. - Hard version: zero-sum, exploitation, when I grow you go down (not much evidence) - Soft version: the system favors the North, dev. countries struggle to catch up, not zero-sum (more evidence) * system leader = a central country situated in the North that generates radical technological innovation

	Simmons and Elkins (2004): The Globalization of Liberalization: Policy Diffusion in the International Political Economy.
RQ	What can account for the clustered transitions to economic liberalization? (these ties of foreign economic policy liberalization and restriction) How and why do these policy changes diffuse internationally?
Arg	Policy diffusion as explanation for clustering of transitions to economic liberalization: The decision to liberalize by some governments influences the choices made by others. Assumption: the adoption of liberal economic practices is highly clustered in time and space H: Clustering liberal economic practices is due to policy diffusion through two mechanisms: – Competition (altered payoffs): adoptions of a policy change the benefits of adopting it for others – Learning (new information): adoptions provide policy-relevant information on benefits of adopting 3 foreign economic policy areas: ① liberalization of current account ② liberalization of capital account ③ policy of the unification of the exchange rate → constitute the principal aspects of international monetary and financial liberalization over the past three decades. <u>More Hypotheses:</u> Government's liberalization policies will be influenced by the policies of their most important foreign economic competitor The proportion of liberalizations in the sample at large should influence a government's decision to liberalize They expect governments to be influenced by the policy innovations of the best performing economies. They expect a positive relationship between policies of governments with extensive opportunities to share information about the consequences of economic policy innovation Crucial similarity will be a positive predictor of policy diffusion among states
RD	Panel data: Sample: 182 IMF members (1967-1996) Spatial lag model (spatial econometrics): – dependent variable in one unit is affected by the value of the dependent variable in neighboring units ("Lagged": the explanatory variable is the behavior of others a year ago) – Spatial lag models treat spatial dependence in the same way that time-series models treat serial correlation. → lags unit in *space* (not time) – Autoregressive function → expect effects from the network (not only neighbor) – Spatial lag models are best suited for proximity (geographical / cultural / membership / peer group) – Spatial weight matrix: countries adapt to others weighing different factors that are important to them <u>Dependent variables:</u> Binary measures of whether government has adopted (hasn't) economic policies (transitions) in 3 areas of liberalization: ① capital account policy ② exchange rate policy ③ current account policy Data: annual IMF volumes on exchange restrictions <u>Explanatory variables:</u> *behavioral* Diffusion variables that assess the source and strength of policy diffusion paths and indicate changing payoff structures (material or reputational) and new sources of salient policy information - *altered payoffs:* Competition ①Policies of capital competitors, ②Policies of trade competitors Global norms: ③ mean global policy - *new information:*

	Learning from success: ④Policies of high-growth countries Communicational networks: ⑤P. of trade partners, ⑥P. of BIT partners, ⑦P. of PTA partners Cultural similarity: ⑧P. of religion partners, ⑨P. of colonial partners, ⑩ P. of language partners <u>Controls:</u> - economic shocks - external political pressure - domestic political economy To model policy transitions, they employ a **semi-Markov model**, which is commonly used for estimating transitions among mutually exclusive states of being.
R	– Domestic models (domestic factors) of foreign economic policymaking are insufficient. – Policy transitions are influenced by: o international economic competition (reactions to liberalization by other governments which are in competition for the same capital) o the policies of a country's sociocultural peers / channeled learning. (Governments orient themselves towards cultural peers. Cultural values are a source of identity, with highly material consequences to policy making)
L	Various possible mechanisms! Log variable is driving choices (dependent variables on both sides). Such an analysis cannot clarify the underlying mechanism. You see that choices of countries are interdependent but you don't know what is really driving the others (systematic factors, dyadic factors or individual predispositions?)
!	Study relates to Liberalism **Galton's problem:** The Problem of external dependencies in making statistical estimates when the elements sampled are not statistically independent. It is problematic to draw inferences from cross-cultural data. Different cultures/societies develop and adopt similar behaviors and practices through a transfusion process. → Problem: making statistical estimates when the elements sampled are not statistically independent E.g. Asking two people in the same household whether they are in favor of free trade, for example, does not give you statistically independent answers.  3 factors involved: - systemic factors: impact of ex shocks - dyadic factors (proximity): observing what the neighbor does - individual predispositions

	Persson and Tabellini (2004b): Constitutional Rules and Fiscal Policy Outcomes
RQ	How do electoral rules and forms of government influence fiscal policy?
Arg	Theory: based on theory that has the general predictions that ① proportional electoral systems and ② parliamentary regimes should be associated with more public goods, larger and more universal welfare programs, and a **larger overall size of government**. ① proportional electoral systems → larger welfare prog. / public goods / overall size of government: proportional electoral systems tilt the composition of public spending toward programs benefitting large groups in the population. Reason: **1. district magnitude:** (=how large the share of the legislature is in a typical district) In proportional elections, legislatures are elected in large districts, giving parties strong incentives to seek support from broad coalitions in the population. → everyone has an incentive to represent as many people as possible. Thus, they promise more things to more people. But the problem is that because they act together, no one is accountable (NO ACCOUNTABILITY). The gov grows because the more politicians represent more groups, the more public goods will be provided because they promised things to so many different groups. And no one from the public will say to the government that it spent too much because they cannot attribute the high spending to a particular politician / party. Majoritarian (plurality) elections are conducted in small districts, causing politicians to target smaller but central constituencies. → Here the politicians are accountable (ACCOUNTABILITY). The problem here is that there is an incentive to only represent small groups and not the broad public. Thus, politicians go for the swing voter because a very tiny number of voters can make the difference. The gov spending will be lower and because of accountability benefits are going to be targeted to particular localities what leads to less public goods. **2. electoral formula** (how vote shares are converted to seats shares)**:** Under proportional representation, you need 50% of the national votes. Thus, politicians have to emphasize broad programs because of proportional representation (REPRESENTATIVENESS) Under majority rule, the size of the minimal coalition of voters needed to win the election is smaller because a party can win with just about 25% of the national vote (50% in 50% of the districts) → winner-takes-all / first-past-the-post (NO REPRESENTATIVENESS) ② parliamentary regimes → larger welfare prog. / public goods, / overall size of government: Reason: **1. vote of confidence:** In parliamentary systems, the president is appointed by the parliament (not directly). The gov is formed based on the number of parties and the parties in power → usually you will have a coalition government. The parties who are going to be the coalition partners will go to the coalition if they get sth for their voters → the gov will grow. These kinds of coalition govs can be brought down at any minute (vote of confidence). If there are parties in the coalition that don't feel happy, they will bring the gov down. So each party will make sure they get sth from the pie → gov grows. (It is the vote of confidence that induces parties to stick in the coalition but in order to stick in the coalition they want sth. for their citizens because they want to get elected again → gov grows.) **2. separation of power:** In a presidential system, the president is elected directly and independently. He needs 50 + votes so he will be tempted to provide a lot of public goods → gov increases, BUT he is accountable to the people, so he will hold a little bit back (ACCOUNTABILITY) and thus it won't grow that much.
RD	– they estimate the effect of electoral rules and forms of government on the size and composition of government spending.

	– Data: cross section of 80 democracies in the 1990' s, but also a few results from an unbalanced panel of 60 democracies for the years 1960-1998. – Dependent variables: fiscal policy outcomes (size of government, ration of central **gov. spending** / GDP, deficit, composition of spending as social security and **welfare spending**…) – Explanatory variables: electoral system constitutional rules (maj, pres), cultural & geographic, constitutional inertia – Control variables: (to avoid omitted variable problem; so controls that do not only affect the DV but also the IV) o colonial history (path dependency) o Political Orientation (Ideology) o Quality of democracy o Age of democracy (If constitutional effects have become stronger over time they could they also be affected by the age of democracy) o Gov spending of last year (autoregressive) o Type of population (average pop age) o Unemployment rate o trade – Basic OLS, additional models: o Relax conditional independence: historical variables determining the current constitution could influence policy outcomes o Relaxing linearity – Heckman-correction model to account for endogeneity Problem: The type of the government and the spending (policy and politics) are not independent. → Matching progress (match countries with similar characteristics). Then compare the level of spending in these two groups (Instrumental Variable Approach) and matching in order to come up with inferences of causalities
R	Size and composition of the gov strongly indicate that the political constitution has a causal effect on fiscal policy. Electoral rule has strong influence; a switch from proportional to majoritarian elections in a country reduces total government spending by about 5 % of GDP and welfare spending by about 2 % of GDP. Presidentialism reduces the overall size of government by as much as majoritarian elections, roughly 5% of GDP. Parliamentary elections lead to smaller govs and smaller welfare programs than proportional elections. Presidential democracies are associated with smaller govs than parliamentary democracies as predicted by theory emphasizing the force of confidence requirement.
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	Vučković and Basarac Sertić (2013): The Effect of Political Institutions on the Size of Government Spending in European Union Member States and Croatia
RQ	interaction between political institutions and economic variables. From the aspect of political institutions that are usually analyzed in the literature, all EU countries except France and the UK have a proportional electoral system. Therefore, we analyze the source of variation in government expenditure from the aspect of specific dimensions within the electoral system. Thus, the contribution of this paper to the literature is reflected in analysis of detailed mechanisms, i.e. indirect effects of electoral systems (through selected dimensions of government fragmentation, political competition and political stability) on the size of government.
Arg	
RD	dynamic panel model based on the generalized method of moments (GMM). Why this method: dynamic panel models are often used in economics since even though the coefficient on the lagged dependent variable is not of direct interest, allowing for the dynamics may be crucial for recovering consistent estimates of other parameters. Since the dataset used in this paper is characterized by a smaller number of periods and large number of observation units, the GMM estimator is used. panel dataset of 26 countries (25 member states of the European Union and Croatia) for the period between 1995 and 2010. Dependent variable: average size of government spending in the EU–27 **Variable** | **Description** | **Source** *exp* | Total general government expenditure (in % of GDP) | Eurostat, Croatian National Bank Explanatory variables: **Variable** | **Description** | **Source** *herfgov* | Herfindahl index | Database of Political Institutions (DPI) *polityIV* | Political competition | Polity IV Project *stabs* | Political stability | Database of Political Institutions Control Variables: **Variable** | **Description** | **Source** *bdp_gr* | Real GDP growth rate | Eurostat *pop* | Share of population aged 60 years and over | Eurostat

	control variables: gdp_gr and pop. Variable gdp_gr represents the value of the real GDP growth rate and it is used as a proxy for general economic development and the impact of business cycles on expenditures. The expected sign of this variable can be positive or negative, depending on the discretionary fiscal policy. Furthermore, the variable pop indicates the proportion of the population aged 60 years and over, and as the aging population puts additional pressure on the increase in total expenditures (primarily through spending on pensions and health care)
R	results show that government fragmentation and political stability affect the dynamics of budgetary expenditures in line with theoretical assumptions. Regarding the implications of this research for Croatia, it has been shown that a higher degree of government fragmentation leads to an increase in government spending, which is a significant result since Croatia has generally had some form of coalition government.
L	A lot of problems in that paper! They take the number of parties as given (and often equal to two) and not endogenously dependent on the electoral system. But, majoritarian elections are strongly associated with fewer parties. As a result, majoritarian parliamentary systems are more likely to produce single-party majority governments, whereas coalition and minority governments become more likely under proportional elections. The type of the government (because we are focusing on democracies) and the type of the electoral system a country has is endogenous to sth! They have democracy as a control variable (a joke)!!
!	Bad example!

	Acemoglu and Robinson (2008): The Role of Institutions in Growth and Development.
RQ	What can be done in order to induce economic growth and improve living standards in a society? Causes of cross county differences in economic development and economic growth Are institutions key determinants of economic outcomes or secondary arrangements that respond to other, perhaps geographic or cultural, determinants of human and economic interactions
Arg	Theory is about how endogeneity of economic and political institutions is working. They want to explain how you can go back and explain the different growth in the North and the South. – Economic growth is related to the ability of a society to increase its *human capital, physical capital* and *improve its technology* – institutions are the fundamental cause of economic growth and development differences across countries and that it is possible to develop a coherent framework for understanding why and how institutions differ across countries, and how they change. – our state of knowledge does not yet enable us to make specific statements about how institutions can be improved (in order to promote further economic growth). Nevertheless, we can use this framework in several ways: o to illustrate the potential pitfalls of institutional reforms. o to structure our understanding of cases of economic success. – Definition of institutions: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." Three important features of institutions are apparent in this definition: ① that they are "**humanly devised**," (menschengemacht) which contrasts with other potential fundamental causes, like geographic factors, which are outside human control; ② that they are "**the rules of the game**" setting "constraints" on human behavior (Spielregeln, die Vorgaben für das menschliche Verhalten vorgeben); ③ that their major effect will be through incentives **(incentive based)** Anreize – Three institutional characteristics: **1) economic institutions** = collective choices of the society (endogenous to society). They influence the distribution of economic gains (= not all individuals will prefer the same economic institutions). → leads to the conflict of interest over the choice of economic institutions and the deciding factor is the **political power** of the different groups. **2) political institutions** they determine the constraints on and the incentives of the key actors, but in contrast to economic institutions, in the political sphere. Examples of political institutions include the form of government (democracy), and the extent of constraints on politicians and political elites. **3) political power** = also endogenous to society. 2 different components of political power: de jure political power: refers to power that originates from the political institutions in society. de facto political power: A group of individuals, even if they are not allocated power by political institutions, may possess political power; for example, they can revolt, use arms in order to impose their wishes on society. This type of political power originates from both the ability of the group in question to solve its collective action problem and from the economic resources available to the group.
RD	Settler mortality rate as an **instrument** for *current* **political institutions**!! It is a good instrument because an instrument variable (proxy) should not have affected the outcome variable (economic growth) in the past. And there is no way that the economic growth today has affected how long the settlers in the colonies lived. The mortality settler rate had to do with what type of institutions they developed! → European colonialization / settlement patterns of Europeans as **a source of exogenous differences in institutions**: In order to analyze factors that cause different sets of institutions, one needs to isolate a source of exogenous differences in institutions*, so that one can approximate a situation in which a number of otherwise-identical societies end up with different sets of institutions. → European colonization is useful to investigate these issues. * An exogenous difference is an explanatory variable that does not influence the output today directly, but by affecting the settlement patterns of Europeans, it may have had a first-order effect on institutional development. → The key requirement for an instrument is that it should have no direct effect on the outcome of interest (other than its effect via the endogenous regressor).

	Two sources of exogenous variation in institutions (instrumental-variables for broad institutional differences across countries) that may have persisted to the present: 1) settler mortality rates → Europeans settled where the disease environment was not too bad. Where they didn't settle in large numbers because of diseases (Malaria) the Europeans set up extractive institutions to exploit the indigenous population. Where Europeans did not settle in large numbers they introduced institutions with larger property rights (settlement-oriented institutions) 2) how densely different regions were populated before colonization→ another source of different institutions (because in more densely settled areas it was profitable for colonialists to introduce extractive institutions to exploit the indigenous population). Thus, European settlers established → **extractive institutions** (unfavorable to economic growth) in places with **high** population density / urbanization, **large** indigenous population and **more** developed civilization. → **settlement-oriented institutions** (conductive to economic growth) in places with **low** population density / urbanization, **few** indigenous people and **less** developed civilization. → the kind of logic (extractive vs not extractive institutions) could also be a factor of the geography or the decease environment of the country.
R	Pitfalls of Reform: Economic growth if there is change in the political equilibrium that pushes through reforms! Why are there dysfunctional political equilibria? Changes based only on de facto power are likely to be reversed in the future (e.g. because other groups holding de jure power come back) Changes based only on political institutions (de jure) are insufficient or even counterproductive (may still leave sources of de facto power intact) e.g. US South after Civil War → **Seesaw effect:** taking away one instrument without changing the balance of power will lead to the use of other instruments (e.g. clientelism in Latin America, downsizing public sector in Africa) → Reforms do not work if they don't change the political equilibrium/balance of power → Changes need to affect both de jure and de facto BUT: **path dependence** (even if both de facto and de jure change)! > **Iron law of oligarchy**: a new elite will behave like the old used to (e.g. Bolivia) > **Fighting fire with fire**: to get rid of bad leaders, people elect new bad leaders → need to change elites' incentives Bottomline: • Changing economic institutions doesn't work → seesaw • Reforming political institutions doesn't work → De facto power persists and overrides Change both de facto and de jure doesn't always work → path dependence
L	There are significant challenges with the mortality data, particularly given that in a number of cases mortality rates for countries were not based on data collected within their borders, but rather imputed from countries with similar disease environments.
!	see-saw effect: directly reforming specific economic institutions won't work without changing the balance of power in society or the political equilibrium → the see-saw effect: replace one inefficient instrument (patronage) for another (repression). Path dependence: Reforming political institutions (i.e. altering the distribution of de jure power in society) won't work either if de facto power persists and overrides the effects of reforms to political institutions. Simultaneously changing both (de jure and de facto) may not achieve real reform either because the political equilibrium may be path dependent, meaning that those who acquire power in the new political equilibrium do not have the correct incentives (= **the iron law of oligarchy**) or the citizens support a leader as bad as the current one (= **fighting fire with fire**)

	Glaeser, La Porta, Lopez-de-Silanes and Shleifer (2004) : Do Institutions Cause Growth?
RQ	Do political institutions cause economic growth, or does growth and human capital accumulation lead to institutional improvement?
Arg	2 approaches to challenge: 1) institutional view that emphasizes that good institutions (constraints on the executive) lead to growth. 2) development view that emphasized that you have to first accumulate human and physical capital and that leads to institutional development
RD	They revisit 3 measures of institutions used in the current economic growth literature to operationalize political institutions:

Measures for political institution (≠ instruments)	Critique of Glasner et al.
① risk of expropriation	① and ② by construction do not describe political institutions: they are outcome measures where ① reflects the government's past restraint from expropriation and ② reflects the government's quality. These measures confound constraints on government with dictatorial choices (they do not code dictators who choose to respect property rights any differently than democratically elected leaders who have no choice but to respect them). Thus, they do not proxy for institutions. Moreover, these are subjective measures that rise sharply with the level of economic development → raising severe doubts that the causality runs from these measures to growth rather than the other way around.
② government effectiveness	
③ constraints on the executive	③ is in principle linked to constraints on government, but in reality is constructed to reflect the outcomes of most recent elections. In developing countries, this measure is **extremely volatile**, and cannot be plausibly interpreted as reflecting durable rules, procedures or norms that the term "institutions" refers to (institutions are a long-term thing).

→ The authors show that the 3 conventional measures of institutions are uncorrelated with constitutional constraints on government that scholars have just begun to use. All this evidence sheds doubt on the proposition that the measures of institutions used in the growth literature reflect any "deep" parameters that they are purported to measure.

Dependent variable:

growth of per capita income between 1960 and 2000

Explanatory variables:

- initial income per capita (as suggested by Barro, 1991)
- initial education
- share of a country's population in temperate zones
- eight institutional variables entering one at a time

R	– They find that the initial level of human capital of a country and the average level of its institutions over a period of time, predict its level of economic growth over that very same period of time. BUT: in some cases (North vs. South Korea), initial levels of constraints on the executive (both initially dictatorships) do not predict subsequent economic growth (S.K. growth, N.K. not), whereas initial levels of human capital continue to be strong predictors. → OLS evidence is not supportive of the proposition that constraints on the executive cause growth, but it is supportive of the proposition that the more basic cause is human capital. – human capital is a more basic source of growth than are the institutions – poor countries get out of poverty through good policies, often pursued by dictators, and subsequently improve their political institutions.
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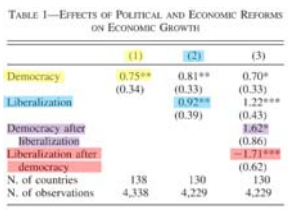
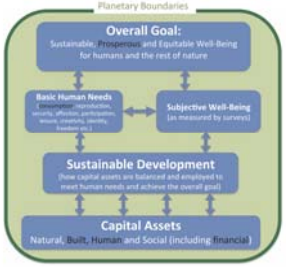
!	NEW-GROWTH THEORY (= Endogenous growth theory) – emphasized importance of technological innovation by private firms (endogenous) – focuses on the role of human capital – theory where you can manipulate productivity: invest in people, more skilled people = more productive

	Persson and Tabellini (2006): Democracy and Development: The Devil in the Details
RQ	1. What is the effect of democracy on economic growth? 2. What are the effects of the forms of democracy on economic growth? 3. What are the effects of expected and actual democracy in economic growth?
Arg	Interplay btw economic liberalizations and democratization (sequence of reforms is crucial)
RD	Annual observations for 150 countries, 120 regime changes, 1960-2000 Polity IV, per capita income, panel regression Estimation by difference in differences, where countries changing regime are the "treated" and those that do not are the "controls".
R	1. Results for effect of democracy on economic growth: Table shows the interplay between democratizations and economic liberalizations. Both induce accelerations of growth, but the sequence of reforms is crucial:  TABLE 1—EFFECTS OF POLITICAL AND ECONOMIC REFORMS ON ECONOMIC GROWTH (1) (2) (3) Democracy 0.75** (0.34) 0.81** (0.33) 0.70* (0.33) Liberalization 0.92** (0.39) 1.22*** (0.43) Democracy after liberalization 1.62* (0.86) Liberalization after democracy −1.71*** (0.62) N. of countries 138 130 130 N. of observations 4,338 4,229 4,229 – Becoming a democracy has a large positive effect on growth (accelerates growth by 0.75%) – Also reforms of liberalization (liberalizing the economy) has a significant and positive effect on growth (accelerates growth by 0.92%) –But if we look at the sequence, countries liberalizing their economy before extending political rights do better than those who first establish a democracy and after that liberalize their economy. For countries where: **1. Liberalization → 2. Democracy** (like South Korea) the effect is **positive** and significant. = accelerates growth by 1.62%. • Countries where democracy was first and then economic liberalization followed (**1. Democracy → 2. Liberalization**) showed in turn a significantly **negative effect** on growth!! (-1.71 percentage points) Explanation: 1. Democracy → 2. Liberalization: If you have a democracy first, it is more likely that you are going to have a lot of interest groups! And interest groups are not conducive to economic growth! Furthermore, democracies often have the tendency to do things for their masses, so you try to please all, and you are not efficient, you waste a lot

	2. Results for effect of **form of democracy** on economic growth: Presidential (proportional) democracy leads to faster growth than parliamentarian. Growth is slower in parliamentary democracy because if you spend a lot to provide for all these groups, you are wasting resources (you have higher taxation, less money to be put on the side for investment). 3. Results for the effects of **expected and actual** democracy on economic growth: Taking expectations of regime change into account helps identify the stronger growth effect of democracy. If you switch from democracy to autocracy (expected as well as actual regime change) leads to a huge loss of economic growth!! TABLE 2—FORMS OF DEMOCRACY, GROWTH, AND ECONOMIC POLICIES (1) Growth (2) Government consumption (3) Liberalization Democracy = presidential 1.00** (0.51) 1.87*** (0.54) 0.07*** (0.02) Parliamentary democracy −1.61*** (0.59) 4.89*** (0.79) 0.11*** (0.04) Proportional democracy no effect 0.16 (0.49) 1.15** (0.49) 0.11*** (0.03) N. countries 138 150 132 N. observations 4,338 4,552 4,578
L	
!	Barro Effect

	Constanza (2014): Time to Leave GDP Behind. (only COMMENT)
RQ	Finding a better measurement for national success than GDP growth
Arg	Constanza claims that it is time to stop measuring national success with GDP. Because GDP measures mainly market transactions and ignores social costs, environmental impacts, and income inequality. However, promoting GDP growth has remained the primary national policy goal in almost every country. But it would be important to start measuring what actually does make life worthwhile. He suggests that instead of GDP, national success should be measured with a new set of metrics that integrates current knowledge of how ecology, economics, psychology, and sociology collectively contribute to establishing and measuring sustainable wellbeing.  Figure S1. Relationship between the overall goal of sustainable well-being and the subjective and objective elements that contribute to it. Only the items in black are currently partially picked up in GDP. Double-headed arrows indicate that influences go in both directions and that all elements are interconnected. Source: www.asapbali.org
RD	Descriptive measurement Article tries to combine growth and environment. Piles it into an index. e.g. child mortality, happiness index and environmental conditions as indicators Constructing encompassing measure (good for policymakers, less good for social scientists). Constanza cannot explain anything, just has a number in the end. Idea of the Kuznet curve is gone here.
R	
L	Why is the world not following the idea of Constanza? Debates are still about economic growth etc. because it is easier to measure. Methodology to measure GDP is not very good, not comparable. The problem is that GDP is a homogenous unit (all about money) but how do you combine air quality etc (much more heterogenous units) … Keep things apart is saver (in research) (not like Constanza does it).
!	

	Dasgupta, Laplante, Wang and Wheeler (2002): Confronting the Environmental Kuznets Curve
RQ	Desgupta et al. review research on the environmental Kuznets curve. They look at arguments and evidence on: the positions, the shape, and the mutability of the EKC. And they argue how the curve can become lower and flatter (=avoiding the worst)
Arg	They argue that the shape of the environmental Kuznets curve is not fixed (curve can be lower and flatter) → developing countries don't have to grow rich before they start to care about environment. Reasons for optimism: 1. Environmental regulation: dominant factor in explaining the decline in pollution as countries grow beyond middle-income status 2. Economic liberalization: privatization and elimination of government subsidies reduce the scale of economic activity and change its composition => decrease pollution + firms adopt cleaner technologies (cheaper and more profitable) 3. Pervasive informal regulation: communities and NGOs a. where formal regulators are present, use the political process to influence the strictness of environmental regulations b. where regulators are absent/ineffective, pursue *informal regulation* = polluting factories negotiate directly with local actors in response to threats of political, social or physical sanctions if they fail to compensate the community (Coase theorem) or reduce emissions 4. Pressure from market agents: consumers may boycott products of polluting firms; bankers may refuse credit (worries about environmental liability); investors may withhold investment (worries about potential financial losses from regulatory penalties and liability settlements) 5. Better methods of environmental regulation: a) Target regulatory monitoring and enforcement on polluting industries/firms b) Move away from command-and-control policies and towards market-oriented forms of regulation (such as pollution charges) 6. Better information: improved information about pollutants, pollution damages, local environmental quality, and cost of pollution abatement enhances the ability of a. local communities to protect themselves b. regulators to enforce environmental standards

	c. market agents to reward clean firms and punish heavy pollutants **But:** Possible concerns *1. Will countries need to suffer lower environmental quality in the short and medium run?* Not if they enact and enforce appropriate environmental regulation *2. Globalization and risk of a "race to the bottom":* because high environmental standards in high-income countries impose high costs on polluters, firms relocate to low-income countries where people are eager for jobs and their environmental regulations are weak or non-existent (the *"pollution havens"* hypothesis). The "race to the bottom" argument is not supported empirically (few cases that pollution havens can emerge in extreme cases) *3. Are other pollutants rising?* Yes, emissions of toxic organic chemicals remain largely unregulated almost everywhere *4. Building effective regulatory capability:* appropriate legal measures for regulation, effective monitoring and enforcement of regulatory compliance *5. International assistance:* trade and aid sanctions are inappropriate and ineffective methods, the international community can support programs aiming at a. providing public, easily accessible information about polluters, pollution damages, local environmental quality and cost of pollution abatement b. supporting the development of stronger regulatory institutions and cost-effective measures to reduce pollution
RD	
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	Bernauer and Koubi (2009): Effects of Political Institutions on Air Quality
RQ	They test the effects of political institutions on air quality (SO_2 concentrations). More specifically, they test 3 institutional effects: (1) **the degree of democracy**, defined in terms of institutional arrangements that affect political leaders' selection and their incentives to provide public goods in order to survive politically (i.e., the size of the winning electoral coalition relative to the electorate) (2) **the type of democratic government** (i.e., parliamentary vs. presidential) (3) **interest group influence**, defined as labor union strength, share of green parties in national parliaments, and civil liberties (which we interpret as a proxy for aggregate interest group influence). > *Labor union strength*: employment protection index (= influence of labor unions on legislation) > *Green party*: share of seats > *Civil liberties*: Freedom House Index
Arg	They relate air quality to: (1) the degree of democracy defined in terms of institutional arrangements. Theoretical argumentation: Institutional arrangements shape the selection of leaders as well as their incentives to provide public goods. Because the institutional features of the **selectorate** and the **winning coalition** determine whether governmental policies provide public or private goods. **selectorate:** the group of people who can affect the choice of leaders and be the recipients of the benefits distributed by leaders **winning coalition:** the subgroup of the selectorate maintaining incumbents in office in exchange for special privileges In autocracies: **small** winning coalition + **large** selectorate → leaders have to provide the winning coalition (elite) with **private goods** if they wish to remain in power. Moreover, autocracy promotes **loyalty** to the leader → further enhances the provision of private goods. In democracies: **large** winning coalition + **relative small** selectorate → leaders have to provide the mass with goods => **public goods**. Moreover, democracy promotes **weak loyalty** to the leader → forces leaders to adopt policies that provide a relatively high level of public goods (such as better environmental quality) to ensure their political survival. (2) the type of democratic government — i.e., parliamentary vs. presidential Parliamentary systems: usually coalition government → each party of the coalition wants sth for their voters + they can bring down the gov at any minute (vote of confidence) → the things for the voters will be provided = **more public goods** Presidential system: president is accountable to the people, thus he will make sure the gov size doesn't grow too much → **less public goods** *Other explanation:* In presidential systems, unstable legislative coalitions and the struggle among different minorities over different issues on the legislative agenda lead to inefficiently low spending on public goods. **But:** According to the *selectorate theory*, presidential systems, which necessitate a large winning coalition, provide more public goods than parliamentary systems, which require a smaller winning coalition. (3) interest group influence, defined as labor union strength, share of green parties in national parliaments, and civil liberties Theoretical argumentation: Median voter: In autocracies: **small elite decides** → use resources for **personal wealth** → if elites would have to bear the costs for stricter environmental policies they will not implement them. → autocracies are likely to underprovide public goods (inc. env. quality) In democracies: **median voter decides** on public policy → median voter faces lower costs from env. policies compared to the economic elite = **implementation of stricter env. policies is more likely**. *counter-arguments:* Political myopia: in democracies, governments have shorter planning horizons because of political myopia. The social costs of current economic behavior materialize in the future → but in democracies the politicians face frequent elections and can't take costly decisions (stricter env. policies) with only long-term benefits without fear of been punished by myopic voters. Interest groups and institutional sclerosis (rigidity): in mature democratic systems there are many established special interest groups who have no incentive to make sacrifice for society as a whole

RD	H1. The more democratic a country is, the lower its SO_2 concentrations. ↑ Dem → ↓ SO_2 H2.1. The greater the strength of interest groups that tend to lose from more stringent environmental policies, the higher the SO_2 concentrations. ↑ interest groups → ↑ SO_2 H2.2. The greater the strength of pro-environment groups, the lower the SO_2 concentrations. ↑ pro-env. groups → ↓ SO_2 H2.3. Civil liberties (a proxy for aggregate interest group influence) have a negative (positive) effect on SO_2 concentrations. civil liberties → ↓↑ SO_2 H3. For democracies, presidential systems experience lower SO_2 concentrations than parliamentary systems. Presidential → ↓ SO_2 Parliamentary → ↑ SO_2 Dependent Variable: Environmental quality: Air pollution: **SO_2 concentrations** (concentrations rather than emissions since con. is more likely to influence the median voter directly in daily life than emissions per se) unit of measurement: micrograms per m^3 *Reasons:* 1. used by numerous national and international orgs to describe air quality. 2. SO_2 emissions can be controlled (if govs wish to) by altering the techniques of production 3. Good reliability and availability of data (for large numbers of countries and over long time periods) Experimental Variables (Political): • Size of winning coalition relative to selectorate (W/S) to measure the degree of democracy. (It accounts for the impact of institutional arrangements on political leaders' incentives to provide public goods in order to remain in power) • Parliamentary/presidential system (0-1,BDM et al,2003) • Labor union strength (Employment protection index, 1-20; Nickell, 1997) • Green party shares in national parliaments (Armingeon et al, 2004) • Civil liberties (Freedom House, 1-7) Wide range of economic and other control variables: - scale effect (intensity of economic activity; GDP per square kilometer for each city and each year) - composition effect (capital intensity of production; capital to labor ratio) - technique effect (income; three-year average of lagged GDP per capita) - trade openness (the ratio of the sum of exports and imports to GDP) - topography (central or rural location) - temperature and precipitation - time trend Statistical procedure: Fixed and random effects estimations applied to pooled cross-sectional data Data: annual observations (1971-1996) from 42 countries (collected through Global Environment Monitoring System)
R	– The degree of democracy has a positive effect on environmental quality. – Presidential democracies enjoy a better environmental quality than parliamentarian democracies. – Labor unions have a negative effect on environmental quality, and green parties a positive effect. – Civil liberties do not have any effect beyond that present in the power of labor unions and environmental groups. Thus, these two special interest groups capture adequately any effects that civil liberties may have on the environment.
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	Bättig and Bernauer (2009): National Institutions and Global Public Goods: Are Democracies More Cooperative in Climate Change Policy?
RQ	Are democracies more cooperative in global environmental policy (output)? Do democracies contribute more to the provision of global public goods (outcome)? => Focus on climate change, one of the most important global public goods issues facing mankind.
Arg	Even though the complex nature of global problems may weaken the effect of democracy on the provision of public goods still such weakening should be less in democracies than non-democracies. *Policy output vs policy outcome* Policy output: Democracies are more likely than autocracies to cooperate at the international level, that is, they are **more likely to participate** in and sign/ratify international environmental regimes. Policy outcome: Democracies, because of reasons such as availability of resources, mitigation costs, efficiency of implementing agencies, are **less able to reduce emissions** relative to their willingness to do so.
RD	H1. More democratic countries exhibit stronger political commitment to climate change (Policy output: composite index (ranging from 0 to 1 with higher values indicating more cooperative behavior) measuring the extent of political, legal, and administrative commitments to climate change mitigation: i.e., ratification of the UN Framework Convention of Climate Change and the Kyoto Protocol) H2. More democratic countries contribute more to climate change mitigation in terms of emission reduction. However, this positive democracy effect is weaker than the democracy effect on policy output. (*Policy outcome:* index assessing emissions trends (ranging from 0 to 1 with higher values indicating more cooperative behavior) and CO2 emissions)
R	– Net effect of democracy on policy output is positive – Net effect of democracy on policy outcomes is not significant – Democracy increases green demand, green demand has a positive effect on policy output (but not outcome) – Country specific climate risk has no significant effect on climate policy – Will democracies perform better in the long-run? (YES)
L	
!	Conclusion Democracies perform better at the political commitment level than in terms of cutting their emissions = "words and deeds" are not strongly related mainly because democracies have hard time in restricting individual freedom and curbing transport related emissions.

	Dorussen, and Ward (2010): Trade Networks and the Kantian Peace
RQ	Do trade networks reduce interstate conflict? **Empirical Puzzle constructed out of an unresolved empirical question**: with their new method (network approach) they come to a different conclusion. Their principal motivation is that previous studies only focused on direct links (that is kind of inconclusive, they don't find that much, but they focus now also on indirect links / embeddedness)
Arg	They use classic liberal arguments to construct their theory / they cite classical liberals → "Peace is the natural effect of trade. Two nations who traffic with each other become reciprocally dependent; for if one has an interest in buying, the other has an interest in selling; and thus their union is founded on their mutual necessities" (De Montesquieu 1748). Argument: Trade is a good thing, it is conducive to avoiding armed conflict among countries
RD	Data: Pooled cross-sectional time-series data on state dyad-years, 1948-2000 Previous literature looked at dyads (directed dyad = you care about the direction, who causes, who receives, you have more observations; vs. indirect dyad where you just have country A and B and you don't care about the direction). In the old trade literature, you had just direct trade relationships → you would use measures like: product /average/sum of democracy level… Good measure for direct trade dependency (**trade openness**): Look at trade flows from CH to DE, exports from CH to DE, imports of CH from DE and how much the two countries trade with each other relative to the size of their economy. Here: they integrate a systemic view → 3 network variables for trade openness (liberal trade argument) 1. STEP: direct trade dependence (dyadic trade variable) More sophisticated: use direct dyads to measure **direct trade dependence on each other**: Because if you have the average dependency score among two countries, you don't have information about who is more dependent on whom. If your argument was: if CH is more dependent on trade with DE than DE is dependent on CH, you could make an argument that the more dependent country is less likely to attack the less dependent country. 2. STEP But: if we measure only direct ties, you would expect higher risk of armed conflict because they don't trade much which each other. If you look at the indirect relationship you would expect that war is less likely because more complex networks probably increase costs of a war and uncertainty of the outcome of the war. → (triadic trade variable) 3. STEP (innovative) **They look at the whole system → embeddedness (how many relationships)** → (systemic trade variable) → in the end they get a number for each country or each country-pair Then regression models with this dyadic data set

R	if two countries are strongly embedded in the global trading network, they are less likely to go to war. Trade promotes peace Trade is equally important for peace as democracy!!
L	It's pure speculation, they don't provide a causal mechanism. But Bernauer really liked it
!	Clearly driven by liberal perspective Parallel to the democratic peace argument Main message: Trade induces peace → trade allows states to communicate better and have more networks and in time, states who communicate more have less disputes Punchline: Embeddedness in international trade networks significantly reduces the likelihood of war

	Sattler and Bernauer (2010): Gravitation or Discrimination? Determinants of Litigation in the World Trade Organization.
RQ	Are smaller economies or poorer economies facing some sort of discrimination? → Is there a power effect in terms of who uses the system? Is the WTO DSM (Dispute Settlement Mechanism) system biased in favor of more powerful countries and countries with greater legal capacities (richer countries)?
Arg	Right-over-might-idea (not true domestically and probably not true internationally but that is the idea they have): everybody is equal in front of the law → The US and Cambodia should be dealt with in exactly the same way in WHO. So Cambodia should be able to sue the US if they don't like what the US does and if they are found to be on the rights side, they should get that right. Theoretical explanations: **① Relative power (vs. absolute economic size / gravity effect)** **③ Income** **② Preponderance** **④ Legal capacity** Arguments explaining the dominance of large economies in WTO dispute settlement: – Discrimination (coercion): o Standard power argument: if the complainant country is more powerful than the target country, it can impose greater costs on the target with less harm to its own economy → No support: it doesn't matter whether the complainant or the defendant is more powerful o Power preponderance: when power asymmetries are high, out-of-court solutions are more likely (greater powers, both as complainants and as defendants, can impose their will upon smaller ones) → Support o Legal capacity argument: countries with smaller legal capacity are less likely to be able to use improved opportunities for taking legal action in the WTO → No support (Problem of endogeneity with capacity: is capacity really independent from dispute initiating?) – Gravitation (one-sided cost-benefit calculation): o Large economies participate in disputes disproportionately often (diversifies economy, greater market size) → Proximity argument: countries which trade a lot will have many instances of dispute → Support
RD	Dependent variable: dispute initiation (how many disputes a member country initiated in a given year) Explanatory variables: relative power (economic size as GDP is for power argument) preponderance income legal capacity (Income as GDP/capita is for capacity argument) Control variables: trade flows democracy retaliation Data: Directed dyads, 1995–2003 Method: Cross sectional design (negative binomial models) and TSCS design (selection models) Prediction: large-small or small-large will not use the dispute settlement mechanism because they are likely to find an agreement amongst themselves.

	Difference standard power and power preponderance: in standard power, it is important which one of the two countries is more powerful (e.g. standard power predicts that in large-small the larger will beat up the smaller in WTO, whereas preponderance predicts they will settle outside WTO) **Dyad characteristics** / **Predicted conflict propensity** Complainant/defendant: Standard power; Power preponderance; Legal capacity; Gravity Small/Small: Intermediate; High; Low; Low Small/Large: Low; Low; Low; Intermediate Large/Small: High; Low; High; Intermediate Large/Large: Intermediate; High; High; High
R	– Gravity effect dominates – Preponderance effect (suggests hidden discrimination) – No income or legal capacity effect At first sight there doesn't seem to be discrimination because there is this gravity effect But at second glance there is sth going on that we don't fully understand, but the **preponderance effect** (= that you have a large power asymmetry between two countries) that we see probably suggests that there is some sort of uneven dealing going on → if one country is a lot more powerful than the other, you don't see a lot of disputes which suggests (only partial correlation) that the bigger country gets what he wants outside of the system. They are more powerful and don't need to go to court (just hold a gun to towards the smaller country). On the other hand, the small one is so scared about taking the big one to court that. → In both ways it is compatible with the not so glorifying argument that you get power in the system that makes this correlation. the main driver of dispute initiation is a **gravitational** one: larger economies and bigger traders are more likely to become involved in trade disputes primarily **because their economies are more diversified**, and also **because greater market size makes them more attractive targets of litigation**. no evidence for discriminatory effects against countries with small legal capacity but: more complex form of **power bias** → a **preponderance effect**. → disputes among country dyads including a much more powerful defendant than complainant or vice versa are dealt with outside the WTO. → worrying finding because it is easier to reduce legal capacity differences than to reduce power differences.
L	Only partial correlation = no proof of the argument (no causal effect) but at least this partial correlation is compatible with the argument that larger countries are probably getting what they want outside the system from the smaller ones.
!	Realist perspective: about power and discrimination ❖ **Power** and **capacity bias** in the WTO dispute settlement mechanism (large vs small economies) ❖ Much **support for gravitation**, little for discrimination (some preponderance) Whole point: **look at legalization beyond the nation-state** Contributions: 1. **Gravitational effects:** larger economies are pulled to WTO more strongly (about absolute economic size of both complainant and defendant) 2. **Power preponderance**: dyads strongly different in power are less likely to go WTO 3. **Standard vs zero-inflated** (since dispute initiation is a rare phenomenon, you'll have a lot of zeroes in the data (countries which just don't trade with each other) → cross-sectional, not binary variable anymore but count Further research: explaining dispute escalation, rather than just initiation. Moreover, what types of disputes are more conflict-prone? Insights ➢ Trade liberalization tends to promote trade flows. ➢ Trade liberalization can mainly be explained by domestic preferences, political institutions, and the international system. ➢ The WTO plays a crucial role in this regard: solving commitment and time-inconsistency problems by reducing transaction costs. ➢ However, despite (or because of) its significance, the WTO is not free of criticism. ➢ Current research primarily focuses on the WTO's DSM and PTAs

	Bernhard & Leblang (1999): Democratic Institutions and Exchange-Rate Commitments.
RQ	Under what conditions will politicians commit to a fixed exchange rate regime?
Arg	Existing literature: - *optimal exchange-rate literature:* structure of a nation's economy (openness, country size, labor mobility, intl. macroeconomic shocks) strongly influences its choice of regime. *Problem with this literature:* does not does not specify the origin of politicians' policy preferences. *Bernhard & Leblang's argument:* that the configuration of domestic political institutions will influence politicians' need to maintain policy flexibility, which in turn shapes their preferences over the exchange-rate arrangement. - *international political economy literature:* Traditionally focused on the presence (or absence) of an international hegemon to explain developments in the international monetary system. View = a major power is necessary to provide credible backing to the world's currency and act as a lender of last resort. *Problem with this literature:* since the breakup of Bretton Woods, states have been able to choose from a variety of exchange-rate arrangements. Under this permissive international monetary system, an emphasis on hegemonic power cannot explain the specific variation of exchange-rate arrangements across states. - *Political economists in general:* (a) developed a variety of domestic-level explanations for macroeconomic policy and exchange-rate choice. They focus on the demanders of exchange-rate policies, including economic sectors or specific interest groups. *Problem with this literature:* These explanations tend to underplay the role of politicians in the choice of exchange-rate arrangement. *Bernhard & Leblang's argument:* Although politicians are responsive to societal interests, they often have incentives and policy preferences independent of societal actors. (b) investigated the relationship between domestic political institutions and exchange-rate decisions. 3 types of arguments link the electoral system to exchange-rate commitments: 1) **Welfare gains:** exchange-rate commitments can help stabilize the macroeconomy, providing an external source of policy discipline → a fixed exchange-rate provides greater social welfare gains. → thus, where politicians are unable to pursue responsible monetary and fiscal policies (weak, unstable governments → proportional representation electoral systems), fixed exchange rates will be more likely. proportional electoral systems ⇒ fixed exchange rates ⇅ opposite assumption 2) **Policy-making capability:** weak or unstable govs (proportional) lack the ability to implement the difficult domestic adjustments necessary to sustain a fixed exchange-rate. Majoritarian systems produce single-party majority govs capable of decisive policy action = more likely to adopt fixed exchange-rates. But proportional representation systems produce coalition govs that have difficulties shifting domestic policies to maintain fixed exchange-rates due to the bargaining and negotiation. majoritarian electoral systems ⇒ fixed exchange rates

3) **Credible commitments / "tying-hands"-argument:** a government will fix the exchange rate if subsequent governments are likely to possess different policy priorities → Politicians in majoritarian systems are more likely to fix the exchange rate.

exchange-rate commitments can serve to constrain the policy options of future governments. The "tying the hands" argument suggests that a government will fix the exchange rate if subsequent governments are likely to possess different policy priorities. In systems where politicians can trust subsequent governments to pursue similar policies (proportional → representativeness) politicians have fewer incentives to make an institutional commitment. In majoritarian systems sharp policy breaks between governments are more likely.
majoritarian electoral systems ⇒ fixed exchange rates

Problem with this literature: relationship between domestic political institutions and exchange-rate commitments is unclear. This is due to the fact that **these arguments do not focus** explicitly on **politicians' incentives**.

Bernhard & Leblang's argument: Politicians' incentives for reelection condition their choice of the exchange-rate regime and thus their incentives reflect the configuration of domestic political institutions, particularly electoral and legislative institutions

Main Argument:
Differences in domestic political systems can account for variations in the choice of exchange-rate arrangements.

Assumptions:
3 factors account for variations in the choice of exchange-rate regime: **① electoral decisiveness**
② opposition influence over policy
③ exogeneity of electoral timing

① electoral decisiveness

Politicians in the governing party(ies) have an **interest in maintaining their position in office**. By serving in office, the governing party(ies) have the ability to control public policy & particularistic policies → enhances their reelection chance.
But, an exchange-rate **commitment (fixed) limits** politicians' ability to influence monetary policy.

In majoritarian electoral systems, where a small number of votes can change the governing party, politicians wish for full control in order to manipulate monetary policy, so they let the currency float (to be able to appeal to key swing voters) because exchange-rate commitments could affect their ability to remain in office.
majoritarian: if fixed → cannot appeal swing voters → affects ability to remain in office → prefer floating

In proportional representation electoral systems, a more fixed exchange rate may help in coalition bargaining by providing a focal point for parties with diverse interests over monetary and economic policy. Parties in coalition government might agree on a fixed exchange-rate focal point (a "transparent" policy rule) as a way to settle conflicts about policy.
proportional: if fixed → serves as focal point to bargain over monetary and economic policy → prefer fixed

❷ opposition influence over policy

In majoritarian govs, opposition parties are excluded from legislative policy process, these cannot influence policy in order to please their constituents ⇒ strong incentive not to risk the position in office = they don't want to limit their ability to influence monetary policy

majoritarian: opposition excluded → incentive not to risk position = incentive to be able to influence monetary policy → prefer floating

In proportional govs, opposition parties have a larger role, can influence policy even while in opposition = less unwilling to lose some policy discretion with a fixed exchange-rate.

proportional: opposition not excluded → less unwilling to lose some discretion with a fixed exchange-rate → prefer fixed

❸ exogeneity of electoral timing

In parliamentary systems, governing parties can call for an election at any time. → The gov will optimize the timing of the election based on its standing in the polls, economic conditions etc. ⇒ **electoral timing is endogenous to the gov's political calculations.** In these systems politicians do not need to manipulate monetary policy to insure an economic boom at a prespecified election time. Instead, politicians may manipulate the timing of the election to coincide with opportune economic conditions. = governing parties will be less opposed to a fixed exchange rate.

parliamentary: elections whenever they want → electoral timing endogenous to political calculus → prefer fixed

In other systems, electoral timing is exogenous. Politicians stand for election at a predetermined time, regardless of political and economic conditions. In these systems, politicians in the governing parties have more incentive to manipulate policy to produce good economic conditions for the election period. A fixed exchange rate not only limits their discretion over policy but also makes domestic economic conditions (and their electoral consequences) vulnerable to external shocks. Consequently, politicians in systems with exogenous timing will prefer a floating exchange.

other: elections predetermined → electoral timing exogenous → want to be able to manipulate policy for election period → prefer floating

RD

Hypotheses:

- the majoritarian–low opposition influence systems will be least likely to participate in a fixed exch-rate regime
- the proportional–low opposition influence systems will be somewhat more likely to fix the the exch-rate
- the proportional–high opposition influence systems will be most likely to participate in a fixed exch-rate regime
- countries with exogenous electoral timing are more likely to adopt a floating exchange arrangement, even after other factors are take into account (these are: Israel, Norway, Sweden, CH, US)

Sample:

exchange-rate regime choices of 20 democracies, 1974 – 1995
pooled cross-sectional time series data

DV: choice of regime

trichotomous: fixing (unilateral peg)
floating
multilateral currency agreement (MCA) participation in the European Exchange Arrangement (=Snake), or in the European Monetary System (EMS) → fixed

Controls:

Independent Variables	*Operationalization*	*Prediction (probability of fixing)*	
Domestic political institutions			
Majoritarian—low opposition influence[a]	Dummy variable	−	
Proportional—low opposition influence[a]	Dummy variable	−	
Proportional—high opposition influence[a]	Dummy variable	+	
Exogenous electoral timing[b]	Dummy variable	−	
Economic openness			
Trade dependence[c]	(Imports + exports)/GDP	+	
Vulnerability to shocks			
Real effective exchange rate[c]	SD of real effective exchange rate	−	Intl. Systemic Variables
Variability of domestic credit[c]	CV of domestic credit growth	+	
Economic size[c]	GDP (log)	−	
Capital mobility			
Capital controls[d]	Dummy variable	+	
International capital mobility[e]	International borrowing	−	
Domestic macroeconomic conditions			
Growth (logged)[c]	Annual percentage change in GDP/POP	−	
Inflation[c]	Annual inflation rate	+	
Political variables			
Partisanship[f]	Left party strength	0	
Elections[g]	Dummy variable for election years	0	
Central bank independence[h]	Legal independence	0	
Europe	In Europe, but not in EC	+	
EC membership[i]	Dummy variable	+	

Political Inertia = exchange-rate arrangement at time t is likely to be conditioned by the exchange-rate arrang. that existed at time t-1

Method:

constrained multinomial logit and binomial logit

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Politicians will be **less likely** to adopt a **fixed** exchange-rate regime /floating is more likely in systems where:
→ costs of serving in the opposition (of electoral defeat) are **high**
→ electoral timing is **exogenous**

Politicians will be **more likely** to adopt a **fixed** exchange-rate regime in systems where:
→ costs of serving in the opposition (of electoral defeat) are **low**
→ electoral timing is **endogenous**

- **Proportional** & **high opposition** influence systems: **most likely** to **fix** their exchange rate
- **Majoritarian** & **low opposition** influence systems: **least likely** to **fix** their exchange rate
- Proportional & low opposition influence systems fall in between
- **Exogenous** electoral timing: **more likely** to let currency **float**

→ Politicians' incentives play a role in determining the exchange rate regime

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	De Grauwe (2011): The Governance of a Fragile Eurozone.
topic	How monetary union could lead countries to crisis
Arg	in union member-countries (Spain): **lack of monetary authority leads to** fragility (liquidity problems) Countries that join a monetary union (**e.g. Spain**) lose not only the monetary authority (decide on monetary policy), they also lose their capacity to issue debt in a currency over which they have full control. As a result, a loss of confidence of investors can in a self-fulfilling way drive the country into default. This is not so for countries capable of issuing debt in their own currency. → **e.g. UK.** In these countries the central bank can always provide the liquidity to the sovereign to avoid default. This may lead to future inflation, but it shields the sovereign from a default forced by the market. Thus, member-countries of a monetary union become more vulnerable. Changing market sentiments can lead to "sudden stops" in the funding of the government debt, setting in motion a devilish interaction between liquidity and solvency crises.
Ex	Spain and UK have a deficit UK deficit was higher, but Spain run into huge problems (higher risk of defaulting) Spain banks had liquidity problems → insolvency Explanation: • Spain is part of a monetary union whereas the UK is not • Spain has to issue debt in a currency over which gov has no control. → If deficit, investors take money out of Spain (sold Spanish bond and instead buy German bond) and put it for example into Germany → liquidity problem • UK has control over the currency in which the debt is issued. → if deficit, investors can not take money out of UK and put it in other country because only UK has pounds → cb will have to put money in economy which may lead to future inflation → but no liquidity problem
solu- tion	He proposes to deal with these problems in a monetary union: → **euro bonds**! = create some type of insurance → if govs get into problems, then their central banks could get money from sth like the International Monetary Fund (IMF) but for Europe (EMF). → and the **insurance** (EMF) is financed with euro bonds. → And there are conditions to fulfil in order to get these kinds of loans → so idea is to create some kind of mechanism in the EU to avoid this misalliance betw the countries → European EMF: countries pay the premium based on their fiscal position (healthiness of their economy). Countries with more risk have to pay more. → **like this you avoid the moral hazard problem!** **moral hazard problem: If you are insured you act riskier → has to do with the dissimilarity of information betw. parties.** → if you have an insurance policy for everybody that is going to increase the moral hazard, but if you price the premiums according to the existing behavior (the economic conditions) then the problem is solved! → you need collaboration!

	Claessens et al. (2010): Cross-Country Experiences and Policy Implications from the Global Financial Crisis
RQ	How did a country's macroeconomic and financial performance during the crisis depend on its initial conditions? Aim: improve understanding of the causes of the crisis and how it spread. 1. review how the crisis originated, and summary of the pre-crisis conditions in domestic and international economic spheres → suggests that the crisis stemmed from **multiple factors**, some common to previous financial crises, others new. 2. Econometric analysis of how the crisis evolved and spread across countries (investigation of the link between the impact of the crisis and countries' characteristics) → shows that this crisis propagated mostly through **international financial connections**. 3. lessons for macroeconomic policy and reform of national and international financial architectures
Part1	**PRE-CRISIS CONDITIONS** Aim: review how the crisis originated, and summary of the pre-crisis conditions in domestic and international economic spheres Method 1. review to elaborate on conditions common to past financial crises and on conditions new to 2008 financial crisis 2. Grouping of countries: various countries were affected at different points in time by the crisis (entered into recession), based on this, 5 groups of countries can be identified. a country's international exposure to the crisis was measured by **financial linkages** and **real linkages** • *measuring of financial linkages:* **international bank claims**, and **measures of portfolio investment flows**, and **financial inflow/outflow restrictions** • *measuring of real linkages:* **the ratio of the value of exports and imports combined to GDP** Results review 2008 crisis (adverse feedback loops) Bank realizes that many non-performing loans → thus the bank has to keep the money → leads to rapid credit growth → home prices fell and you cannot have any credit → leads to decrease in consumer spending → declines in corporate profitability → with consequent lay-offs, → increase in unemployment, → sharp reduction in consumer spending → further adverse feedback loops New features that were not familiar to past crises: - This crisis largely **originated from overextended households**, in particular through mortgage loans. This affected how the crisis was transmitted from the financial sector to the real sector. - **increased interconnectedness**, both nationally and internationally, among financial markets - prominent role of household indebtedness - spread of crisis differs from previous episodes of financial contagion: Similar to past episodes, first hit were countries with severe imbalances. However, these were not emerging markets that typically are affected the earliest, but **advanced economies** such as Ireland and Iceland **were affected first.** Next were countries with **strong financial links with the epicenter** (the United States): key financial centers and several Western European countries. Most emerging markets were only affected later, when the collapse in global demand led to a contraction in global trade

	Result Grouping The pattern that emerges differs from what was observed in previous episodes of financial contagion. The empirical analysis shows that, as in an epidemic, those countries that had **closer links with the US** financial system or direct exposure to asset-backed securities (those closer to patient zero) **were the first to be affected**. And, also as in an epidemic, those countries with **home-grown vulnerabilities (the weaker individuals)**, displaying features such as **rapid credit growth** and **high leverage**, **asset price bubbles**, and **large current account imbalances**, were the **most severely hurt**. Characteristics of countries first affected: • large domestic vulnerabilities • much higher house price *appreciation* and credit growth • higher household leverage (measured by mortgage-debt-to-GDP ratio) • banks were more dependent on wholesale funding than in the other groups • GDP growth, on average, was higher (suggesting the presence of booms) • larger current account deficits • *no large differences existed between groups in terms of fiscal balances* Those countries that had **more room for policy intervention (individuals with better access to care)** were able to **bounce back relatively earlier and faster** than others. The empirical results do point to areas where vulnerabilities might be detected: • asset-price bubbles (especially if fueled by credit growth), • accumulation of private sector debt, • increasing dependency on external and wholesale funding, and • failure to reduce public debt and build up fiscal room in good times.
Part2	**Performance During the Crisis** Aim analyze how the crisis evolved and spread across countries Method **Econometric analysis** to investigate the link between the impact of the crisis and countries' characteristics Sample: countries most integrated with world financial markets and trade: specifically, most advanced economies and the major emerging markets. First: Macroeconomic Performance **3 economic performance indicators:** • the **duration** of the recession (if a decline in GDP happened); • the **severity** of income loss following the crisis; and • the **decline in growth** in the crisis years compared to the pre-crisis period Trade openness → measured by exports plus imports to GDP financial sector development → measured by the ratio of private credit to GDP Second: Financial Sector Performance main indicator of financial sector stress → the Financial Stress Index (FSI)

Results: **Macroeconomic Performance** during the Crisis

significant predictors for economic performance (for all three performance indicators):

- house price appreciation,
- bank credit growth prior to the crisis, and
- size of the current account deficit

→ the greater the house price appreciation and credit growth, and the larger the current account deficit, the longer, the more severe, and the more adverse the aggregate economic slowdown.

partly significant for economic performance:

- trade openness *positively associated with 2 economic performance measures (the severity & relative adversity).*
  → economies that depend more on trade are more vulnerable to global trade shocks

- the share of foreign bank claims *positively related to the duration of the crisis*
  → countries with banks that have a disproportionally high share of foreign claims outstanding are more vulnerable to global banking shocks

not significant for economic performance:

– financial sector development (the ratio of private credit to GDP)
– mortgage market development
– wholesale funding dependence

Table 4. Regression results: macroeconomic performance

Dependent variable:	Duration								
House price appreciation	0.012***								
Growth in bank credit-to-GDP		0.019**							
Domestic credit/GDP			0						
Mortgage debt-to-GDP				0.006					
Wholesale funding dependence					1.605				
Fiscal balance						0.005			
Current account balance							−0.067***		
Foreign bank claims								0.002*	
Trade openness									0.001
Log per capita income	0.806***	0.439**	0.617**	0.428	0.787***	0.622***	0.739***	0.728**	0.620***
Observations	45	56	55	45	38	56	56	24	56
R-squared	0.276	0.261	0.164	0.122	0.313	0.167	0.324	0.229	0.168
Dependent variable:	Severity								
House price appreciation	0.051***								
Growth in bank credit-to-GDP		0.074**							
Domestic credit/GDP			−0.021						
Mortgage debt-to-GDP				−0.044					
Wholesale funding dependence					2.338				
Fiscal balance						0.137			
Current account balance							−0.231**		
Foreign bank claims								−0.001	
Trade openness									0.015**
Log per capita income	−0.067	−1.205	0.449	−0.779	0.395	−0.633	−0.093	−0.944	−0.689
Observations	45	56	55	45	38	56	56	24	56
R-squared	0.277	0.094	0.036	0.082	0.03	0.013	0.121	0.044	0.039
Dependent variable:	Decline in growth								
House price appreciation	0.012***								
Growth in bank credit-to-GDP		0.018***							
Domestic credit/GDP			−0.003						
Mortgage debt-to-GDP				−0.001					
Wholesale funding dependence					−0.171				
Fiscal balance						0.029			
Current account balance							−0.050**		
Foreign bank claims								0	
Trade openness									0.003***
Log per capita income	−0.186	−0.309**	−0.008	−0.359*	0.037	−0.17	−0.0545	−0.011	−0.187
Observations	45	56	55	45	38	56	56	24	56
R-squared	0.436	0.176	0.027	0.1	0.003	0.026	0.189	0.005	0.075

These findings suggest that it is not so much the level of financial deepening or the structure of the financial system, but rather the occurrence of rapid increases in financial deepening combined with sharp rises in asset prices that generates vulnerabilities.

Recessions do last longer in richer countries, reflecting the advanced-economy nature of this crisis. Credit disruptions can be long lasting.

Results: **Financial Sector Performance** during the Crisis

For almost all countries, this peak is reached in October 2008. → country-specific factors mattered little in terms of financial market indicators.

significant predictors for financial sector performance of individual countries

- The ratio of private credit to GDP is positively related to the increase in FSI, suggesting financial stress was greater in economies with greater financial deepening.
- Higher house price appreciation and more sizeable mortgage debt are associated with greater increases in financial vulnerabilities.
- Trade openness (-) appears to reduce financial vulnerabilities, though the effect is only marginally significant.

Table 5. Regression results: financial sector performance

Dependent variable:	FSI								
House price appreciation	0.021*								
Growth in bank credit-to-GDP		0.0302							
Domestic credit/GDP			0.025***						
Mortgage debt-to-GDP				0.043**					
Wholesale funding dependence					1.857				
Fiscal balance						0.014			
Current account balance							0.028		
Foreign bank claims								0.003	
Trade openness									−0.013*
Log per capita income	1.130**	0.872*	0.297	0.103	1.097**	1.098**	1.094***	1.053	1.127***
Observations	31	37	36	29	33	37	37	21	37
R-squared	0.272	0.238	0.532	0.301	0.243	0.207	0.211	0.263	0.259

Overall, we find that most of our variables, including most notably credit growth, reliance on wholesale funding, and foreign bank exposure are not significantly related to our indicator of financial stress, **confirming that the financial shock was of a systematic and global nature, affecting all financial markets more or less equally**.

Overall, our initial conditions indicators therefore do a better job in explaining the cross-country variation in macroeconomic performance than the variation in financial sector performance.

Part3 Policy Implications

Macroeconomic policy lessons

- asset price booms and excessive credit growth can lead to severe macroeconomic vulnerabilities.
- to discourage speculative behavior, the following regulatory instruments could be used:
  - higher capital ratios can reduce leverage and excessive credit growth;
  - lower limits on loan-to-value ratios can dampen house price appreciation; and
  - higher margin requirements can help limit stock price increases.
- Overall, sound macroeconomic conditions are important. Economies are better able to absorb shocks and grow out of a crisis when they run current account surpluses and have the 'fiscal space' to run larger fiscal deficits when needed.

Reform of the national and international financial architectures

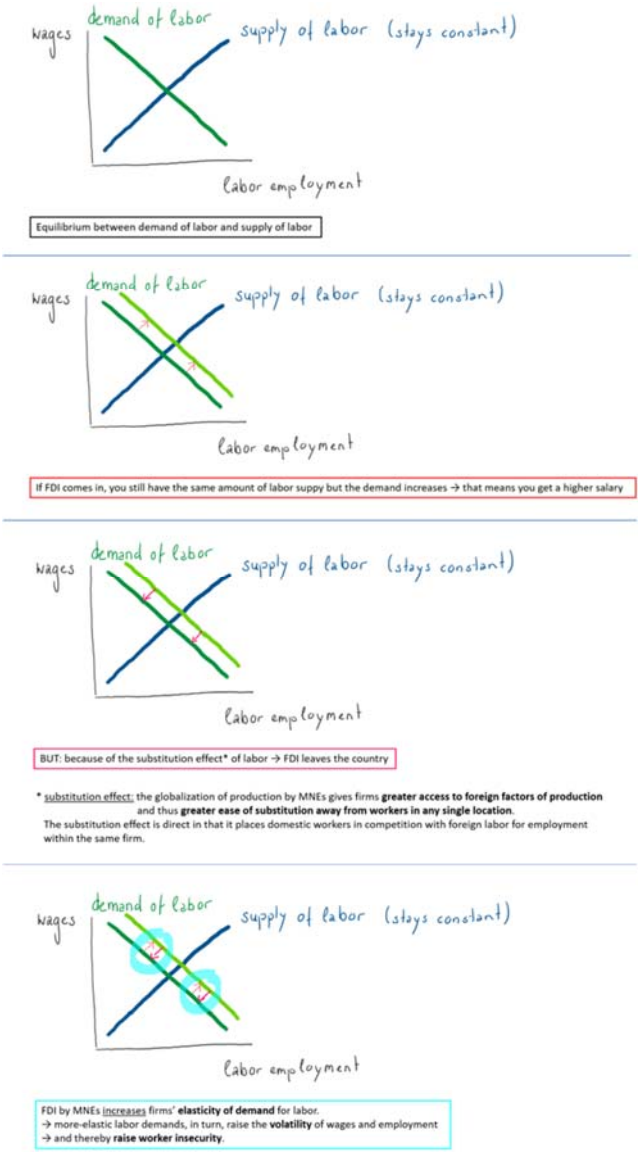
- **financial liberalization** combined with the **existence of underpriced deposit insurance** and **implicit government guarantees** might generated incentives for financial actors to take excessive risks.
- the financial system should be regulated such that the build-up of systemic risk is mitigated.
- **close cooperation among international agencies** to bring together expertise and identify key risks and vulnerabilities.
- **strengthening macro-financial analysis and early warning systems**
- **better cross-border crisis management arrangements**
- **closer cooperation and greater coordination among regulators and supervisors**
- **a greater coordination between macroeconomic and regulatory policy is needed.**

	Bernauer & Koubi (2006): On the Interconnectedness of Regulatory Policy and Markets: Lessons from Banking
RQ	How do regulation and market forces affect bank capitalization? → study examines how *regulation* and *market forces* affect the decisions of banks with regard to how much capital to hold. → puzzle: Banks tend to over comply with international standards. Why this **over-compliance phenomenon**? → study seeks to explain the variation in capitalization across banks and countries by focusing on four sets of variables: 1. market pressure (competition) 2. properties of national regulatory regimes (direct effects of regulation) 3. general economic conditions 4. individual bank characteristics
Arg	Situation: several banks over-complied already *before* the Basle standards. This is not in line with the theory that the US forced the Basle standards upon other countries. → B&K have an explanation for this inconsistency: theory ignores the interconnectedness betw the 2 most important determinants of the capitalization decisions of banks: regulatory policy & market forces. *→ competition before the Basel Accord was already motivating some banks to choose high capital-asset ratios. International competition at that stage was, however, hindered by the lack of common international standards that could facilitate judgement of bank quality. The inability of economic actors to differentiate between banks based on quality meant that poorly capitalized banks were able to free-ride on stronger banks. Such behavior had negative effects on banks holding higher levels of capital (negative externalities). It also contributed to an increase in systemic risk in the world economy. → International regulation thus became necessary not so much because the average bank was undercapitalized, but rather as a means for increasing international competition.* Theoretical explanations: • **regulatory policy**: cannot account for the observed heterogeneity and overcompliance in *capital-asset ratios* across countries and over time • **market forces** (competition among banks): a bank uses its *capital-asset ratios* to improve its attractiveness to depositors relative to competitors (substitution effect) → Interaction between the two: whenever there is a new regulation, individual banks have an incentive to do a bit better than the minimum standard → competitive advantage → overcompliance
RD	Sample: 1,267 banks from 29 OECD countries in 1999 DV: capital-asset ratio (Tier 1 capital) → *see next summary for explanation* IV: • market forces (competition) • regulatory measures and gov intervention • economic conditions • bank characteristics

R	Possible explanations for the over-compliance with intl. standards: • market pressure (competition) increases capitalization • Regulation depends on the measure: o declaring insolvency increases capitalization o promptness decreases capitalization • Deposit insurance: no support for moral hazard argument • Bank assets: too big to fail? Conclusion: synergies between regulation and market forces!
L	
!	**systemic risk** = risk of systemic crisis, notably bank failures leading to bank runs and financial crises.

	Bernauer & Koubi (2004): Banking Crisis vs. Credit Crunch? A Cross–Country Comparison of Policy Responses to Dilemmas in Banking Regulation
RQ	How do policymakers refer to the dilemma "banking crisis vs. credit crunch" → which risk do they prefer to take? The dilemma: **The policy choice** Recessions pose a serious dilemma for policymakers: → *If policymakers act (force regulations)* the probability of bank insolvency and associated social costs is lowered, but there will be high social cost of raising bank capital during recession and increased probability of a credit crunch ⇒ a possible vicious circle: a credit crunch could further exacerbate the recession, reduce profitability further… → *If policymakers don't act (no regulations)* the probability of a credit crunch is lowered, but they may contribute to a higher probability of bank failures. Aim: study the cyclical behavior of bank capital to infer how policymakers respond to the dilemma
Arg	**Policy-makers' choices depend on the state of the business cycle:** • Policy-makers' mandate is to maintain stability in the banking system • BUT at the same time, they are under political pressure not to undertake actions that endanger growth and jobs → They often opt to wait until there are strong signs of turmoil in the banking sector before they act. → B&K's main point: **it is the state of the business cycle that affects the tradeoffs faced by policymakers**
RD	Studying the cyclical behavior of bank capital in 1369 commercial banks from 28 OECD countries from 1992-98 DV: capital-asset ratio (Tier 1 capital *) → a bank's overall risk-weighted capital-asset ratio (here the so-called Tier 1 ratio) captures the overall risk-profile of a bank. The 1988 Basle Accord established a common international definition of bank capital that divides capital into two tiers: **Tier 1 capital (min. 10.5%):** core capital, measures a bank's financial health, used when a bank must absorb losses without ceasing business operation → common across countries **Tier 2 capital (min. 2%):** supplementary capital (revaluation reserves, hybrid capital instruments, …) *→ Tier 1 is comparable across countries, Tier 2 is not* IV: GDP growth Controls: characteristics of banks • return on equity: measure of the return on shareholder funds = **indicator of vulnerability** and of **the possible difficulties a bank may have in raising new capital** • the share of non-performing loans: measure of the amount of total loans which are doubtful = **indicator of bank vulnerability**. *control variables related to bank size:* • the total value of assets • the number of employees

	= **indicators of a bank's reputation, stability, etc.**
R	• The dilemma influences banking policy → **increased sensitivity** in countries that have suffered a banking crisis • Regulators in countries that have suffered a banking crisis = more sensitive to the problem of systemic risk → want to prevent another banking crisis → thus tightening regulation during recessions, even at the expense of increasing the risk of a credit crunch. ⇒ This induces a **counter-cyclical behavior** in bank capitalization. • significant **differences across countries** depending on whether country suffered a recent banking crisis coefficient of GDP is negative → countercyclical variation in the capital-asset ratio. • as growth rate decreases by 1 point, bank capital increases by 2 points. = As GDP growth goes down, capital-asset ratio goes up → country that suffered a recent banking crisis (US and Japan) → **bank capital is counter-cyclical** (= the bank strengthens its capital base **during periods of weak economic activity**.) • Finding is significant only for US and Japan, not much can be said about other countries • study offers an alternative explanation for why the US pushed so hard for the 1988 Basel Accord: it was a **reflection of the increased sensitivity of policymakers towards "unhealthy" banks** (=the US effort reflected genuine concerns about national and global systemic bank risk.) and not primarily to out of competitive self-interest in hurting other countries' banks)
L	
!	**Cyclicality:** • **Procyclical** = economic quantity that is **positively** correlated with the overall state of the economy (e.g. **GDP**) • **Countercyclical** = economic quantity that is **negatively** correlated with the overall state of the economy (e.g. **unemployment**) B&K argument: **counter-cyclical behavior** in bank capitalization (= if economy goes down → more regulation) Question: should government introduce capital requirements when the economy is good (cyclical) or when it is bad (countercyclical)? o it would be better when the economy is good, because it is easier o usually, when the economy is bad, BUT risk of vicious circle: credit crunch could further reduce bank profitability and exacerbate the recession → social costs of raising bank capital during recession is high

	Scheve, & Slaughter (2004): Economic Insecurity and the Globalization of Production
RQ	Does FDI cause economic insecurity in home countries?
Arg	They argue that an **FDI can substantially influence economic insecurity**. An important channel through which FDI can affect labor-market volatility is **by increasing labor-demand elasticities** via the **substitution effect**. The globalization of production by MNEs gives firms greater access to foreign factors of production and thus it is substitution away from workers in any location is easier. As a result, **workers in home countries feel more insecure**. → the central idea is that FDI by MNEs increases firms' elasticity of demand for labor. → more-elastic labor demands raise the volatility of wages and employment and thereby raise worker insecurity.  Theoretical mechanism: FDI by MNEs → increased elastic labor demands → raises volatility of wages & unemployment → increased worker insecurity

	Elasticity of labor demand = Percentage decline (in absolute value) in the quantity of labor demanded in response to a 1% increase in the price of labor → Two components: • Substitution effect = more expensive labor can be replaced by cheaper labor (from developing countries). For a given level of output, how much firms substitute away from labor toward other factors of production when wages rise. → it is about the ease of in and outflow of FDI. • Scale effect = How much labor demand falls after a wage increase due to the rise in the firms' costs and thus the fall in their output → When wages rise, both the substitution and scale effects reduce the quantity of labor demanded.
RD	Sample: Britain is a good case because it closely matches the theoretical framework: high degree of FDI inflow and outflow, and flexible labor markets DV: Individual insecurity as reported in British Household Panel survey (question: satisfaction with job security) IV: • FDI presence (a) if the industry had any positive FDI investment, inward or outward, (b) if the industry's activities do not require producers and consumers to be in the same location • FDI total share: sum of inward and outward FDI stocks • FDI inward share Controls: Individual characteristics (income, education, age, manufacturing, sector unemployment) Method: Linear model, random and fixed effects They look at years separately, because observations over time for the same individual will be more similar than observations across different individuals
R	• parameter estimates are negative for every year except 1992 and turn significantly negative after 1995. This indication of lower average levels of insecurity in later years is broadly consistent with the U.K. macroeconomic performance over the 1990s: initial recession followed by increasingly strong economic growth. Conclusion: FDI activity in the industries in which individuals work is positively correlated with individual perceptions of economic insecurity Implication: possible backlash, liberalization is likely to have consequences on policy opinions
L	
!	FDI activity in the industries in which individuals work is positively correlated with individual perceptions of worker insecurity

	Li, & Resnick (2003): Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries 01:21
RQ	Does increased democracy promote or jeopardize FDI inflows to less-developed countries (LDC)?
Arg	→ theory on the effects of democratic institutions on FDI inflows → the level of FDI inflows depends on the interactions between MNEs and host countries → by affecting these interactions, democratic institutions affect FDI inflows both positively and negatively Why do firms decide to go abroad? → Various theoretical arguments (especially Ownership adv., Location adv., Internalization adv.) They argue that "firms select investment sites based on how well their ownership-specific and internalization advantages mesh with location-specific benefits: host government policies create location-specific conditions that affect how well a firm can exploit its advantages." - Through their ownership-specific advantages, MNCs are more competitive than local businesses → governments can implement protectionist legislation - Governments may offer financial and fiscal incentives to MNCs, expecting technological and managerial benefits Suppressive effects of democracy: • Effect on MNE exploitation of monopolistic or oligopolistic position Internalization and ownership-specific advantages come from oligopolistic market structures → governments can limit this through competition-enhancing legislation Democratic governments want to increase competition to enhance domestic economy and collect votes, whereas in autocracies the winning coalition is smaller, and governments collude with MNCs • Effect on host country industrial policy Through their ownership-specific advantages, MNCs are more competitive than local businesses → governments can implement industrial policies protecting domestic businesses because local businesses and interest groups may organize and lobby • Effect on fiscal and financial incentives to foreign capital Expecting technological and managerial benefits, governments may offer financial and fiscal incentives to MNCs (tax holidays, exemptions from import duties, deductions from social security contributions, accelerated depreciation allowances, investment grants, subsidized loans, donations of land or site facilities, and wage subsidies) → Less likely in democracies than in autocracies, because opponents of FDI can lobby Positive effects of democracy: • credible commitment to protect property rights Democratic institutions are on average **more effective at securing private property rights** than autocratic institutions Stable autocracies may also protect property rights, but their credibility suffers from lacking accountability
RD	Sample: 53 **developing countries** from 1982 to 1995

	Method: OLS with panel-corrected standard errors (PCSE) DV: Level of FDI net **inflows** into a country each year (highly correlated with outflows) measured in billions of current US dollars IV Negative effects of democracy: selection, constraint, competition (from Polity IV) Positive effects of democracy: property rights protection index (different complex models, read again) Control variables: regime durability, political instability, market size, econ. dev., growth, labor cost change, capital flow restrictions, exchange rate volatility, world FDI inflows → Always include economic controls! (else omitted variable bias)
R	• Positive effects on FDI inflows: protection of property rights, growth, GDP, GDP/capita, world FDI, regime durability • Negative effects on FDI inflows: democracy (selection, constraint, competition), exchange-rate volatility, labor cost change, capital controls Democratic institutions affect FDI inflows to developing countries via competing causal avenues: Increases in democracy improved property rights protection, which **encourages FDI inflows** Increases in democracy also **reduce FDI** received by this set of LDCs Bottomline: level of democracy has a negative effect on FDI inflows if property rights are removed → Property rights protection may be more important to growth than democracy → Democracy promotes growth by improving property rights protection (Or maybe the mere *credibility* of upholding property rights)
L	
!	Mechanism by which democracies attract FDI: **property rights** It is not democracy!! It is rather the institutional setting (property rights) of the country that matters!

	Jensen (2003): Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment
RQ	what are the mechanisms by which of democracies attract FDI? empirically assesses the predictions about the political preconditions for attracting FDI
Arg	
RD	cross-sectional and panel regression analysis for 114 countries: 3 types of regressions: 1. cross-sectional regressions: estimate the **effects of** economic conditions, policy decisions, and democratic political institutions (IVs) in the 1980s on the **level of FDI inflows** (DV) in the 1990s. In order to avoid endogeneity (there is always endogeneity: FDI can affect economic growth or the economic variables can affect democracy) he aggregates over the last decade (average FDI in the 1980s) to predict the next decade (average FDI in the 1990s) → so there is no way the FDI in the 1990s affected the economic variables in the 1980s. 2. times series cross-sectional regressions (panel regressions), analyze how changes in economic policies and political institutions affect changes in FDI inflows in the period from 1970-97. 3. Heckman selection model: to explore the robustness of the relationship between democratic governance and FDI. Result: Democracies are better at attracting FDIs *But democracies involve too many things, so in a next step he tests the effects of democratic institutions on country sovereign debt ratings* sovereign debt ratings are chosen because buyers of this foreign loans might have the same political risks as do MNCs → if you see democracies as less risky, that shows to the investors in general that democracies are much more stable / **credible. → its credibility** ↓ He explores the causal link between democracy and FDI by empirically assessing the effects of democratic governance on **country credibility**. In this section I test the effects of democratic institutions on country sovereign debt ratings for seventy-nine countries from 1980 to 1998.
R	• Democratic political institutions are associated with higher levels of FDI inflows. • Democratic governments, even when controlling for other political and economic factors, attract as much as 70 percent more FDI as a percentage of GDP than their authoritarian counterparts.
L	
!	Why do democracies attract more FDI? Credibility

	Jensen (2008): Political Risk, Democratic Institutions, and Foreign Direct Investment
RQ	How do domestic political institutions affect premiums which MNCs pay for risk insurance against government expropriation and contract disputes?
Arg	Existing literature: • Mechanisms through which democracy decreases risk of gov expropriation and contract disputes: o Stability in policy (many veto players, things don't change easily) o Firms can influence policy o Transparency o Reputation costs of expropriation • Mechanisms through which democracy increases risk: o Instability (politicians want to be re-elected; Time inconsistency of democratic leaders) o Competing interest groups, liberalization opposers can organize and influence policy o No special treatment for foreign firms compared to domestic firms Previous studies had conceptualized risk as FDI and found that overall democracy has an ambiguous effect on risk → **Jensen uses a new, more direct measure of risk**: insurance premiums paid by MNCs for investments in those countries Insurance companies distinguish 3 types of risks: - War/political violence - Expropriation (e.g. nationalization, breach of contracts between the firm and the government) - Transfer risks: risk of government restricting capital flows
RD	Data from ONDD (Belgian Export Credit Agency) 7 categories of risk generated through quantitative and qualitative analysis But: forward looking! (Expected risk in the next 15 years) 134 countries Control variables (only variables which are theoretically linked to economic growth): level of development, economic growth, regional dummies Models: ordered probit models utilizing the cross-sectional political risk data o Model 1: baseline (IV: democracy) o Model 2: baseline excluding OECD countries
	o Model 3: baseline excluding outliers on the dependent variable (those with the highest risk) o Model 4: include a measure of natural resource rent (natural resource wealth leads to higher risk) o Model 5 and 6: different measure for political regime (robustness test) → **In all models, democracies are associated with significantly lower risk** → What aspects of democracy drive the effect? o Models 7-10: test for separate aspects of democracy (number of veto players, competitiveness of executive ecruitment, openness of executive recruitment, executive constraints, regulation of participation, competitiveness of participation)
R	→ **In all models, democracies are associated with significantly lower risk** → **the more democratic a country is, the less premium the MNCs pay → so the risk of expropriation and contract disputes is much less** → **the negative effect of democracy is driven by constraints on the executive** BUT again. What exactly about democracy? → **the constraints on the executive**! (to what extent the leaders are constrained from changing the rules of the game) Simulation of predicted values: move from a democratic regime to an authoritarian regime decreases the probability of being in the lowest risk category by 8.8% and decreases the probability of being in one of the three lowest categories by 21.7%. Punchline: Democratic institutions have a major impact on the level of political risk.
L	
!	Why do democracies attract more FDI? Constraints on the executive

	Bernauer, Kalbhenn, Koubi & Spilker (2010): A Comparison of International and Domestic Sources of Global Governance Dynamics
RQ	To what extent is the probability of ratification (PR) of international environmental agreements (**IEAs**) influenced by country external and country-internal effects? →examines how much **states' linkages with the international system**, relative to **domestic factors** (income, democracy), influence the dynamics of global governance efforts. As global governance efforts they take **the behavior** of 180 countries **to ratify** 255 global environmental treaties. they study *determinants of international co-operation* / the effects of **country-external factors** and **country-internal factors** in motivating countries to ratify international treaties (agreements that are open to ratification by all countries globally)
Arg	*foreign policy behavior of countries (international co-operation and global governance efforts) are influenced both by internal (domestic) and external (international) factors.* External (international) effects ← POLICY DIFFUSION *They examine the effects of two distinct types of external factors:* ① Political and economic integration into the international system (refer to rather unspecific influences from being part of the international community) > Involvement in international organizations (**IO MEMBERSHIP**) Argument: countries that are more involved in international organizations are more likely to join international environmental agreements. Because greater involvement in IOs fosters co-operative behavior by reducing transactions costs and creating opportunities for diffuse reciprocity. In addition, it has a 'socialization' effect in terms of creating norms of appropriateness. Hence, being a member of IOs in general might lead governments to value the more generic benefits of international cooperation and thus to adopt this co-operative behavior to very different issue areas and with regard to different forms of international co-operation. Operationalization: the number of IOs of which a country is a member in any given year. Result: IO membership has a statistically significant positive effect on ratification behavior. > Integration in the world economy (**TRADE INTENSITY**) Argument: • Factor endowment (Heckscher-Ohlin): in developed countries, the abundant factor is capital, thus developed countries, which have much capital, may be less willing to participate in intl. env. agreements that hamper their comparative advantage in the production that causes pollution. **→ developed countries should ratify less than LDC** *Reminder:* The H-O model states that a country will export goods whose production uses factors (either capital or labor) that are frequent in the country. → A capital-rich country (e.g. Germany) will export capital-intensive good (e.g. machines), while the labor-rich country (e.g. Brazil) will export the labor-intensive good (e.g. coffee). • Pollution-Havens effect: LDC have a comparative advantage in trade if policy-related differences in tolerance of pollution is considered. If the comparative advantage in trade derives from policy related differences across countries in tolerance of pollution, then the less developed countries, which tend to be more labor than capital abundant, are likely to be less willing to engage in intl. env. co-operation. → LCDs should also be more reluctant to ratify environmental agreements that hurt their comparative advantage which they have due to laxer environmental regulation. **→ LCD should ratify less than developed countries**

⇒ Depending on whether the factor endowment or pollution haven effect dominates, richer or poorer countries will, for reasons of competitiveness, be less willing to join international environmental agreements.

⇒ Consequently, the authors expect negative trade effects on average (the more intensively a country trades (the more open the economy), the greater the loss from a reduction in trade. Environmental regulation increases the costs of producing export goods and thus reduces exports.

⇒ intl. env. reg. increases the costs of exportables → the more a country trades, the larger its losses → the less willing to ratify

⇒ countries that trade intensively are less likely to join international environmental agreements

Operationalization: the ratio of the sum of exports and imports to gross domestic product (GDP)

Result: Trade intensity has a statistically significant **negative effect** on ratification behavior.

② Contingent behavior (illuminates the extent to which the ratification behavior of any given country is affected by whether other countries or specific other countries ratify)

> Contingency effects / Peer group effects ← **POLICY DIFFUSION**
this variable plays a role because it indicates feasibility / costliness and reputation

Argument: Any country's ratification behavior is influenced by the ratification behavior of its peer group (logic of consequence / logic of appropriateness?)

Reminder: Galton argued that cultural similarities could be due not only to evolutionary development but also to common descent and borrowing. He also argued that explanations that did not take into account all these possibilities could arrive at false conclusions. In our case, these driving forces can be conceptualized in terms of country-internal characteristics and country-external factors. = Advice not to examine the effects of unit-internal and unit-external variables in isolation. → Galton's problem points to the difficulty of assessing whether a government makes a specific policy choice because a specific cause/event impacts on all countries or on a given pair or group of countries; for example, pressures arising from globalization may force it to do so, because of internal characteristics, or because this government follows the specific policy choice of another government with whom it shares some common characteristics. By differentiating between contingent behavior, the effects of international political and economic integration, and the effects of domestic forces driving treaty ratification, the approach taken in this article takes into account Galton's problem.

the authors hypothesize peer group effects in three forms:

The propensity of a country to join an international environmental agreement increases ...

Ha: **with the number of other countries that have joined this agreement**. ✓confirmed

Hb: **with the share of other countries in the same geographic region that have joined this agreement**. ✓confirmed

Hc: **with the share of other countries in the same income bracket that have joined this agreement**. ✗ no effect

Operationalization:
several variables to measure contingent behavior:
Ha: the total number of states in the international system that have already ratified the particular treaty.
Hb: the percentage of countries from the same geographical group (region) that have already ratified the particular treaty.
Hc: the percentage of countries from the same income group that have already ratified the particular treaty

Domestic effects

> Democracy

Argument: • demand side: higher civil liberties and better-informed citizens
Citizens know more about environmental issues and can push governments to act
⇒ **the higher the level of civil liberties, the higher the probability that a country ratifies an environmental treaty.**

• supply side: One could argue in both directions. (A) according to median voter theorem, democracies provide more public goods and (B) one could argue that elected governments have shorter planning horizons than non-elected governments because of political myopia (maximizing votes at the next election), democratic leaders may refrain from ratifying intl. env. treaties that impose high short-term costs. Their autocratic counterparts, in contrast, do not face democratic elections and can take more costly decisions (stricter environmental policies) with longer term benefits.
⇒ **because of what existing literature has mainly found, the authors expect that more democratic countries are more likely to ratify international environmental agreements.**

Operationalization:
- Demand side: civil liberties component of the Freedom House index
- Supply side: index capturing the extent of democratic participation (from Polity IV)

Results: Democracy (demand side) affects countries' ratification behavior positively.
Demand side ---**Positive effect**
Supply side ----- **slightly negative effect but less strong**

the effect appears to be mostly due to the demand side of the political system as civil liberties allow citizens to pressure their governments to behave more cooperatively at the international level. The supply side of democracies, the political rights, does not seem to promote international environmental co-operation.

> Income

Argument: Environmental Kuznets Curve: Many forms of environmental degradation first become worse and then improve as income per capita increases. Because environmental quality is a luxury good in the initial stages of socio-economic development, poor countries opt for improving material living standards until they have improved as far as the opportunity cost of stricter environmental policies becomes (relatively) smaller and environmental quality becomes a 'normal' good.
→ country's willingness to ratify an intl env. treaty is positively correlated with income.

Operationalization: log value of GDP per capita and also the squared value of the log of GDP per capita.

Results: Income affects countries' ratification behavior positively.
Countries with a higher GDP per capita are more likely to ratify international environmental treaties, but it also shows that the overall effect of GDP per capita is rather small.

Control variables:

- **Power (=log of population size and log of GDP):** powerful countries could either be role models or use their power to free ride. Thus, they control for this ambiguous effect

Result: **negative effect** → the more powerful a country is (measured in terms of GDP), the less likely it is to ratify a treaty. Thus, more powerful countries, rather than trying to become environmental role models, appear to be able to get away with less co-operative behavior. The negative effect persists when using population instead of GDP to measure a country's power.

- **Domestic environmental quality (log of SO2 emissions per capita):** Countries with bad environmental conditions need treaties the most, but also face the highest cost of implementing → ambiguous effect expected
Result: positive effect → the higher the SO2 emissions per capita, the more likely a country is to ratify global env. agre. This result should be interpreted with caution because the proxy we use is a very crude one. Two potential interpretations: 1. that governments of countries exposed to greater environmental damage use global environmental agreements to tie their hands vis-a-vis opposing domestic constituencies. 2. that governments of such countries use global environmental agreements to purchase international goodwill and improve their reputation, particularly if their environmental behavior generates transboundary externalities (which is often the case with SO2 emissions).

- **Geographic Region:** certain treaties are more important for some regions than for others

Result: countries not located in Europe are less likely to ratify global environmental treaties

- **Age of treaty:** older treaties have more time to get ratified
→ The **baseline hazard** decreases strongly with time. That is, the probability of ratification by any given country is higher shortly after a treaty is opened for ratification and then decreases over time.
Hazard meaning you are exposed to a hazard like an illness and how long does it take you over time to stay out of the agreement

RD

Sample: panel dataset covers global environmental treaty ratifications in the time-period 1950–2000
approx. 180 countries and 255 global environmental treaties over fifty years

Unit of analysis: treaty–country pair per year
this permits analysis of the spatial and temporal evolution of international environmental co-operation, which is particularly important when analyzing contingent (interdependent) ratification behavior of countries.

→ pair each country with each treaty and then look at each year, whether it ratifies or not
(e.g. China + Treaty 1 + 2004 → 0 = not ratified, 1 = ratified)
Time series stops when it's ratified
↓
For each year we estimate the probability of a particular country ratifying a treaty, as described in a later section on statistical method. This approach allows us to include both country- and treaty-specific characteristics. In this article, the term 'treaty-specific characteristics' relates to any condition that varies across treaties, but not across countries.

DV	measured by
the ratification of a multilateral environmental treaty	ratification was coded in binary form. For each year in which a treaty is not ratified by a particular country, the respective treaty–country pair is coded as zero (0). The dependent variable takes the value one (1) in the year the country ratifies the treaty, whereupon this particular treaty–country pair leaves the dataset.

IVs		Measured by
External (international) effects	involvement in IOs (IO membership)	the number of IOs of which a country is a member in any given year
	integration in the world economy (trade intensity)	the ratio of the sum of exports and imports to gross domestic product (GDP).
	Contingency effect / Peer group effect a	the total number of states in the international system that have already ratified the particular treaty. one-year lagged value
	Contingency effect / Peer group effect b	the percentage of countries from the same geographical group (region) that have already ratified the particular treaty. Geographic regions are defined according to the IIASA world population program definition. one-year lagged value
	Contingency effect / Peer group effect c	the percentage of countries from the same income group that have already ratified the particular treaty. They categorize countries into three income groups: low-income countries, middle-income countries, high-income countries one-year lagged value
Internal (domestic)	Income > log value of GDP per capita > squared value of the log of GDP per capita	log value of GDP per capita. A country's wealth is measured by the log value of GDP per capita. Income may also have a non-linear effect on the likelihood of ratifying international environmental treaties. They thus include also the squared value of the log of GDP per capita.
	Democracy (demand side)	civil liberties from the Freedom House Index
	Democracy (supply side)	index capturing the extent of democratic participation in gov (from Polity IV)

Controls	measured by
Power	log of population, log of GDP
Domestic environmental quality	log of SO2 emissions per capita.
Region	dummy variables for world regions to control for specific features of environmental treaties that may attract countries from one region more than others. The regions are Eastern Asia, Western Asia, Africa, Latin America, Europe and North America

Method:

- Binary-time-series-cross-sectional (BTSCS) analysis with cubic time polynomial to approximate hazard. And the variable in the BTSCS framework is observed yearly
- To model temporal dependence, time as well as its squared and cubic term (t, t2 and t3) are included in the models. This approach acknowledges that a country's ratification behavior today depends strongly on its ratification behavior in the years before and thus controls for time effects.

Problem of endogeneity: socialized countries are drawn to IGO membership and to IEA at the same time
→ not really much of a solution, other than the fact that IGO membership is much broader

Simulated probabilities:

- Simulate what happens to DV if IV goes from mean to maximum
- Predicted probabilities for specific country characteristics (e.g. probability that the US ratifies any given treaty based on its trade, IO membership, democracy score, income and air pollution in the year 2000 is 1.4%)

!

- **Effects of international factors are stronger that domestic factors →** the effects of the contingent behavior variables (except for the ratification share in the same income group) are much stronger than the effects of democracy and income.
- **Threshold effects →** if only some countries in a region have ratified a given treaty, the likelihood of another country in this region ratifying this treaty does not increase much. However, if a larger number of countries in a region have already ratified, the likelihood of ratification for the remaining countries in this region increases quite strongly.

Policy implications

While it is obviously difficult to boost income, democracy and other domestic factors that promote co-operation in laggard countries in the short to medium term and at acceptable cost, the results demonstrate that countries interested in the effective formation of global governance systems can positively influence laggard country behavior by moving ahead with ratification. 'Entangling' reticent countries in more international organizations can also be helpful in promoting the formation of specific global governance systems

L

The study cannot control for the selection effect → countries negotiate an agreement, then it is put up for signature, then they go home and they have different mechanisms for deciding whether to formally join. Each country then sends (or not) an instrument of ratification (statement that they join → legal act). So what was criticized is that all this 200 agreements are totally different in their content ("you are comparing apples with oranges").

→ thus, in a follow up study, they examined the effects of treaty design on ratification. So they coded these 200 treaties for their design issues.

Follow-up paper (Depth vs Participation Dilemma):

- An agreement that is very ambitious and deeply worked out is maybe better at solving problems, but you are not going to attract many people who are willing to engage in it. On the other hand, if you have an agreement that is extremely soft and almost cost-free, everybody is happy to be onboard, but it has no problem-solving effect.
- RQ: Do the more ambitious agreements (the ones that put more restrictions on your sovereignty) attract less people? Is there such a dilemma?
- there seems to be **no** depth vs participation tradeoff: higher commitment levels don't seem to deter ratification much
- Positive compliance mechanisms (assistance) foster ratification, whereas negative compliance mechanisms (enforcement and monitoring) are insignificant
- For weak forms of dispute, dispute settlement provisions increase ratification
- Secretariats (direct costs) deter ratification

!

The most important empirical finding is that, overall, international factors have a stronger effect on co-operative behavior (in the form of treaty ratification) than domestic factors, such as income and democracy.

→ this implies that Galton's advice not to examine the effects of internal and external variables in isolation is also useful in the study of international politics.

added value: studying **external and internal driving forces of international co-operation** side-by-side and a systematically comparison of their (relative) importance

	Bernauer & Gampfer (2013): Effects of Civil Society Involvement on Popular Legitimacy of Global Environmental Governance
RQ	How does civil society involvement affect public legitimacy of global governance? A legitimacy deficit in global environmental governance (= if the political system is not able to make its citizens believe that existing political institutions are the most appropriate for society) is likely to reduce public support for global environmental policies. If citizens perceive both aspects of global policy-making, the **input aspect** (transparency, representation) and **output aspect** (problem-solving) as legitimate, in the sense of "governance by the people" and "governance for the people", then public support is likely to be stronger
Arg	Idea: **solve the legitimacy deficit through civil society participation** (but many skeptical voices)

Proponents	Skeptics
- creates more transparency - gives non- or underrepresented societal groups/countries more voice - cuts through long chains of delegation in representative democracy → enhances democratic accountability - better problem-solving through added and improved knowledge	- weak democratic legitimation of civil society organizations - civil society groups lack transparency and accountability - representation of narrowly defined, parochial interests - dominance of Western civil society groups

RD

- **3 survey-embedded experiments** via crowd-sourcing on-line platform
- Large, heterogeneous convenience samples, mainly from India and USA (the two largest democracies on Earth)
- Subjects read short scenario of climate negotiations (control, on process legitimacy, on outcome legitimacy), then fulfill a task
- After experiment, survey on political and environmental attitudes

Experiments:

1. Preferences for civil society involvement in general:
   Subjects create their "own" national delegation (5 representatives) from a pool of government agencies, NGOs, business associations, research institutions
   → Randomly administered priming on desirable process or outcome characteristics of negotiations

2. Does civil society involvement increase popular legitimacy (support) of the negotiations (test causal mechanism), and which aspects of legitimacy specifically:
   scenarios varying civil society inclusion

3. How do changes to the status quo of civil society involvement affect popular legitimacy (conditional effects of civil society involvement):
   different participation forms, success of negotiations, changes of status quo

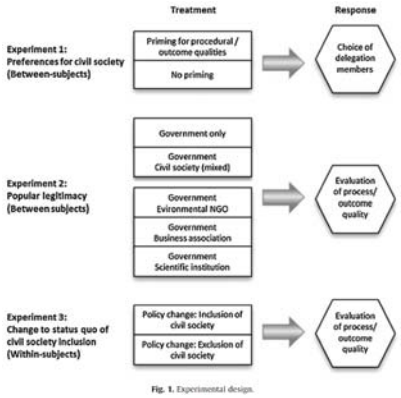


Fig. 1. Experimental design.

R	The results speak in favor of civil society involvement. *Results 1:* individuals favor civil society involvement in global climate policy-making. - In all treatment conditions: civil society make up on average 50% of delegation - Process-treatment: more NGOs selected; outcome-treatment: more scientists selected - Relative aversion against business representatives *Results 2 & 3:* individuals pay more attention to changes in the status quo than to static conditions: popular legitimacy of global climate governance decreases when civil society is excluded, and increases when civil society is added. The latter finding has implications for current debates on how to address the persistent stalemate in global climate negotiations. → (2) no significant effect, except negative effect for business and (3) most important finding! → highly significant, especially exclusion. → if you exclude civil society (when they were included before), this has the most negative impact on people's support) Conclusion: • Involvement of civil society - in the form examined - does not per se increase support or perception of process and outcome legitimacy (although may be beneficial in some other way) • Generally seen as welcome • Once civil society is included, it may be detrimental for legitimacy to exclude it ⇒ Civil society - Has become integral part of international environmental policy making - May potentially improve the legitimacy and outcomes of intergovernmental decision-making BUT many challenges to positive contributions: - Unbalanced participation - Resource constraints - Restricted access to negotiations
L	
!	Legitimacy (*Lipset 1983)* the ability of the political system to foster and maintain the belief that existing political institutions are the most appropriate and appropriate for society. Civil Society Civil society organizations are voluntary associations that explicitly seek to shape the rules that govern aspects of social life and are institutionally separate from state actors. They are not directly profit-oriented and do not seek political office. Non-profit but business-related organizations, such as chambers of commerce or trade associations, can thus also be regarded as part of civil society. Definition Global Governance (Weiss and Thakur 2010) **the complex of** *formal* and *informal* processes, relationships, institutions, and mechanisms *between* and *among* markets, organizations, citizens, and states, both *inter-* and *non-governmental*, through which collective interests on the global plane are **articulated**, rights and obligations are **established**, and differences are **mediated**.