

**Politics of State Aid in the European Union:
Subsidies as Distributive Politics**

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In a world of increasingly mobile capital, labor and production, governments are engaged in a heated competition to attract businesses by offering subsidies and tax breaks. Governments around the world face similar pressures to offer incentives to business; however, they differ on the types of incentives they offer. For instance, in the 1990s, Austria and the Netherlands provided subsidies for research and development (R&D), while Portugal, France and Ireland focused on aiding specific sectors, and Belgium and Italy stressed regional assistance. What accounts for this variation in governments' policy choices in subsidies?

This is the central question this paper seeks to explain. I argue that the electoral institutions and party politics in a country influences governments' choice of the target of subsidies. I conceptualize subsidies as a form of distributive spending, which allows politicians to concentrate benefits in a single constituency and diffuse the costs to all taxpayers. Subsidies vary on the degree to which their benefits are concentrated. Subsidies to specific firms in difficulty, for instance, are designed to benefit a small constituency. Subsidies to R&D or to worker training, however, benefit broad sections of the society. My argument in this paper is that electoral institutions and party politics that encourage politicians to provide particularistic benefits will lead them to disburse subsidies with a narrow focus. Electoral institutions that create incentives for politicians to appeal to broader sections of the society, by contrast, will lead to an emphasis on subsidies with a broader focus.

Drawing on a growing literature on electoral institutions in political economy and comparative politics, I focus on the effects of district magnitude, party discipline and ideological polarization of parties on politicians' incentives for providing particularistic policies. I propose that small district magnitudes, low party unity and small ideological distance between the major parties create incentives for governments to provide more particularistic benefits to their

constituents. In countries where district magnitudes are small, party unity is low, and ideological distance is small, we would expect politicians to offer subsidies with a narrower focus. In contrast, in countries with large district magnitudes, high party unity, and large ideological distance between the major parties, politicians have incentives to appeal to a broad constituency, and thus emphasize subsidies with broader goals.

This paper uses data on subsidies collected by the European Commission to test these hypotheses on 15 European countries in the period 1992-2001. The countries and the time period are chosen maximize the variance on the independent variables within the confines of available data. This allows me to draw more generalizable conclusions about the influence of electoral politics on methods that politicians choose to subsidize industries.

This paper contributes to two distinct bodies of research in political science. First, it contributes to the literature in political economy on the effects of parties and electoral institutions on distributive politics in a political system. While there is refined theoretical research in this area, empirical research, especially involving comparative data, is scant. This paper contributes to this literature by testing some of the central claims of this literature with new and innovative data. Second, this paper contributes to our understanding of the politics of subsidies to businesses in European countries. In the European Union, there is increasing attention on “state aid” as a remaining protectionist measure. The European Commission is focusing its efforts on convincing member states to redirect their subsidies from specific sectors to less market distorting forms of subsidies such as R&D and employment subsidies. This paper brings insights into why governments choose certain types of subsidies over others, and thus it can contribute to the understanding of state aid in Europe and to its policy discussions.

Subsidies as Distributive Politics: Background, Trends and Existing Research

Government support to businesses can take many forms, such as protecting the industry with tariffs and quotas on foreign goods, by adopting favorable regulations, or by offering fiscal and financial incentives to businesses. In this paper, I focus on the financial and fiscal incentives granted to business, for which I adopt the term subsidies. The OECD defines public support to business as any form of direct or indirect selective financial support, such as grants, low-interest loans, and tax breaks (OECD 1998). The European Commission adopts an even broader definition based on the Treaty on European Union (TEU), which includes any state measure that confers an economic advantage on the recipient and that is granted selectively to certain firms or for the production of certain goods.¹ It includes financial, fiscal, and in-kind benefits to firms such as direct grants, tax breaks, tax deferrals, soft loans and loan guarantees (Thomas 2000, 55). This paper defines subsidies as any form of state support to industry that is granted selectively to certain firms, based on the definitions of the OECD and the EU.

Subsidies became important industrial policy tools in the 1960s, initially as a response to trade liberalization (Trebilcock, Chandler, and Howse 1990, 104). The nature and uses of subsidies have not remained constant over time, however. In the 1970s, subsidies were directed frequently towards aiding specific sectors in decline such as steel and shipbuilding, and creating national champions in strategic sectors such as aerospace. This earlier understanding of subsidies has changed since the mid-1980s. While traditional justifications for subsidies continue to be emphasized occasionally, increasingly, new policies and attitudes towards industrial policy have emerged.

In the United States (US), the shift has been towards policies aimed at new capital formation and the stimulation of demand (Eisinger 1988, 10-12; Gray and Lowery 1990, 4). In

¹ Article 87, Treaty on European Union.

the European Union (EU), increasing policy entrepreneurship by the Commission and changing attitudes in some of the member states led to a move away from subsidies to declining sectors and towards horizontal and regional subsidies (Pontusson 1992; Smith 1996). These include subsidies to promote R&D, subsidies for small and medium sized enterprises (SMEs), for employment, and subsidies that aim to narrow the gap between the poor and rich regions of the EU. These types of subsidies are deemed more acceptable by the Commission, because they are less harmful for competition in the single market and more appropriate for making European economies more viable internationally (Commission 2001). The shift towards horizontal policies occurred gradually in European countries, starting with Britain in the late 1970s, Sweden and Denmark in the mid-1980s, and France, Italy, Portugal and Spain in the 1990s.

International attempts to control subsidies proliferated in response to the increasing use of subsidies since the 1960s. In addition to the efforts of the EU to regulate member state subsidies, there have been attempts to discipline subsidies multilaterally at the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), and bilaterally with the United States-Canada Free Trade Agreement (Morici 1996; Trebilcock, Chandler, and Howse 1990). Subsidies have also been a concern at the domestic level in federal states, where regions compete for investments by engaging in costly subsidy races (Thomas 2000).

Academic research on subsidies is only recently and slowly catching up with these policy debates (Cini and McGowan 1998). One of the objectives of this paper is to close this gap in our understanding of the politics of state support to business, by linking two distinct and previously unconnected bodies of research. The first of these is the comparative work on subsidies in the OECD and EU member countries. The second is the research on distributive politics in

comparative political economy. In combining insights of these two bodies of research, this paper fills a gap in each of these; that is the lack of comparative and systematic empirical research.

A substantial body of research focuses on industrial support policies of developed countries. Both the EU and the OECD collect and publish data on subsidies in their member states, which facilitates systematic comparative studies on subsidies.² Comparative research on subsidies in OECD and European Union (EU) member states emphasize politicians' incentives for granting subsidies. Verdier (1995) argues that politicians "maximize their chances of staying in power through deliberate use of subsidies to structure the political debate and embed factor owners into stable policy networks" (Verdier 1995). His analysis of subsidies in OECD countries for the period 1986-1989 supports his argument that left leaning governments offer subsidies favoring labor and right leaning governments offer subsidies favoring capital.

Zahariadis (2001) investigates the factors affecting the level of subsidies in OECD countries in the period 1990-1993. He argues that industries with high asset specificity have higher costs of switching production in the face of international competition, thus they lobby more intensely for subsidies. He finds that the level of subsidies varies systematically with the degree of asset specificity employed in a national economy (Zahariadis 2001, 603). Similarly, Alt et al. (1999) explore business lobbying for subsidies in Norway after the rise in oil revenues allowed the government to disburse more subsidies. They find that firms with specific assets are more likely to lobby the government, controlling for firm size and export dependence.

A central argument in this body of research concerns subsidies as a political tool for helping governments get reelected. There are strong motivations for policy-makers to offer subsidies to businesses. For elected officials, "political payoffs [of subsidies] are dramatic"

² The European Commission publishes an annual *Survey on State Aids in the European Community* since 1989. Two publications of the OECD on state support to industry cover the period 1970-1988 and 1989-1995 (Ford and Suyker 1990, OECD 1998).

(Eisinger 1995). Business incentives are good politics, because “there is little risk to politicians when incentives fail because failure can be blamed on economics, market forces, or dysfunctional corporate behavior. Political dividends during economic good times are great because policy makers can claim credit for intervening”(Buss 2001, 92). Noto argues “if nothing else, subsidies allow politicians to take some decisive action and demonstrate that they care about attracting business to their jurisdiction” (Noto 1991, 256-7).

This literature provides important insights into domestic and international factors that affect the amount of subsidies governments offer. These authors highlight the demand side of subsidy policies, with a focus on the preferences of domestic interest groups and coalitions, and how these influence government policies. However, this body of research has not attempted to differentiate between different types of subsidies. It also has not explored the impact of political institutions on governments’ industrial policies.

A large body of research has emerged in political economy on how electoral institutions, party and electoral politics shape economic and fiscal policies and outcomes (Franzese 2002; Garrett 1998; Hallerberg and von Hagen 1999; Milesi-Ferretti, Perotti, and Rostagno 2002; Persson and Tabellini 2001; 2005; Remmer 1993). A second line of research in this vein considers how these factors influence the nature and amount of distributive politics that goes on in a political system (Lancaster and Patterson 1990; Stratmann and Baur 2002; Weingast, Shepsle, and Johnsen 1981). In this paper, I draw on this second line of research on electoral politics. I propose that subsidies to business can be used as a form of distributive politics.

Distributive policies allow the concentration of benefits and the diffusion of costs (Franzese and Nooruddin 2004; Lowi 1964). They are “characterized by the ease with which they can be disaggregated and dispensed unit by small unit, each unit more or less in isolation

from other units and from any general rules” (Lowi 1964, 690). Pork barrel projects are the classic example in the US context, whereby the benefits are concentrated in a single district and the costs spread across all districts (Cain, Ferejohn, and Fiorina 1987, 210). The beneficiaries of distributive policies are a narrow group of citizens. Thus, they differ from broad programs in the form of general public goods like defense or broad redistributive programs like social insurance or pensions, which provide benefits to many citizens (Persson and Tabellini 2005, 14).

Research exploring the effects of electoral institutions on distributive politics focuses on different types of government spending, government transfers and levels of corruption as dependent variables. Persson and Tabellini (2005), for instance, test for the effects of electoral institutions, such as district magnitude, ballot structure, and proportionality on fiscal and economic performance, and levels of perceived corruption. Milessi-Ferretti, Perotti and Rostagno (2002) focus on the composition of government spending, taking transfers as broad redistributive policies, and purchases of goods and services as policies that create local benefits.

This paper takes a different empirical focus to test the major theoretical claims of this literature. I explore whether electoral institutions and party politics influence governments choice of how to support businesses. Most governments provide support to their businesses in the form of subsidies, tax breaks, free land or employment training credits. I propose that we can differentiate incentives to business based on whether they benefit broad or targeted constituencies. Governments target specific benefits to voters by offering subsidies with a narrow focus. Subsidies directed towards rescuing a firm in difficulty and subsidies to specific sectors are more appropriate for targeting a specific, narrow constituency. Therefore, they work as distributive (or particularistic) policies. A second category of subsidies, which includes R&D subsidies, subsidies for SMEs and employment training apply to a broader range of firms.

Therefore, they benefit a broader constituency and are similar to redistributive policies. In this paper, I explore whether electoral institutions and party politics have an impact on what type of subsidies, distributive or redistributive, governments will favor.

This paper contributes to these two bodies of research on comparative industrial policy, and the impact of electoral politics on distribution and redistribution. It draws on the insights of the literature on comparative industrial policies, most importantly on their argument on electoral incentives for offering subsidies. It contributes to this literature by exploring the impact of political institutions on governments' choice of industrial policy methods. The paper also draws on the literature on the impact of electoral politics on economic policies. It uses the insights of this literature to understand government support to businesses. It also contributes to this literature by applying its arguments to a new concept of distributive policy and a new set of data.

Explaining Governments' Choices in Subsidies

What explains governments' choice of subsidies to industry? I propose that electoral institutions and party politics shapes governments' decisions whether to offer targeted subsidies or broad ones. More specifically, I argue that district magnitude, party unity and the ideological distance between the major parties explains whether governments will emphasize narrow or broad subsidies.

The first factor that influences government choice in subsidies is district magnitude. District magnitude refers to the number of legislators that acquire a seat in a typical voting district (Persson and Tabellini 2001, 4). The argument here is that as district magnitude decreases, politicians' incentives for providing targeted benefits increases. There are two reasons for why this should be the case. Persson and Tabellini (2001, 2005) argue that larger voting districts diffuse electoral competition and induce governments to seek support from broad

coalitions in the population, the extreme case being one in which the whole country is one electoral district, while smaller districts channel electoral competition towards narrower, geographical constituencies. “With small electoral districts, typically a party is a sure winner in some districts and a sure loser in others. Electoral competition is thus concentrated only in some pivotal districts, and both parties have strong incentives to target redistribution towards such districts” (Persson and Tabellini 2001, 4-5). Targeted programs are more effective in seeking such narrow support compared to broad programs. Thus, when districts are small, we would expect politicians to have more incentives to provide subsidies with a narrow focus. Conversely, “elections involving larger districts should thus be biased toward broad, nontargeted programs, such as general public goods or broad transfer programs” (Persson and Tabellini 2003, 17).

The second reason why smaller districts are associated with narrow programs is offered by Lancaster (1986) and Lancaster and Patterson (1990) in their research on pork barrel politics. Lancaster argues that the closer an incumbent’s identity is tied to a territorial base, the greater the incentive to support territorially based distributive policies (Lancaster 1986, 70). In single-member districts, the accountability linkage between the incumbent and her constituency is the strongest. Political credit for project allocation is more difficult when more than one individual represents a district. “Multi-member districts create a disincentive for such territorially directed public policies because the electoral accountability link becomes confused” (Lancaster 1986, 70). Lancaster and Patterson’s (1990) empirical research on perceptions of pork barrel in the German Bundestag supports this argument. Similarly, Cain et al. (1986) argue that incentives to create a personal vote are the highest in single member districts, and tend to decline with an increase in district magnitude. In single member districts the electoral connection between the representative and her constituent are more direct and clear. As district magnitude increases,

representatives tend to free ride on the efforts of fellow party members in cultivating a reputation. Applied to subsidies, this argument suggests the following:

H1: the smaller the district magnitude, the greater are the incentives for the government to provide subsidies with a narrow focus. The larger the district magnitude, the greater are the incentives for politicians to offer broad subsidies.

The second factor at the regional level is party unity. Party unity refers to the cohesion of political parties in two contexts, in elections and legislatures (Bowler, Farrell and Katz 1999, 5). Party unity in the context of elections, which is of interest here, refers to whether candidates seek votes based on their personal reputations or on party labels. In other words, it refers to the extent to which the electoral fates of the candidates of the same party are tied together (Bawn, Cox, and Rosenbluth 1999). Scholars identify various factors that encourage personal vote-seeking as opposed to relying on party labels, such as electoral systems, in particular, the ballot structure (Carey and Shugart 1995, Mainwaring 1991), presidentialism, and federalism (Boueck 2002). Party unity will be high, for instance, if the party leadership has control over which candidate gets to be on the party list and their rank on the list. This increases the loyalty of the candidates to the party line (Bowler, Farrel and Katz 1999, 8). If, on the other hand, voters can express their choice over individual candidates, as in an open list system, then party unity tends to be low. This creates intra-party competition and decreases the influence of party leaders on the individual candidates.

Seeking votes based on a personal reputation, in turn, influences how politicians will attempt to appeal to voters. Franzese and Nooruddin argue that where individual politicians are relatively independent of the party and party labels have less meaning, “individual MPs’ electoral districts become more relevant to them and constituency service (including distributive projects) becomes more important to them and their supporters” (2003, 11). Where party unity is

low, individual politicians have incentives to cultivate a personal reputation in the electoral district to differentiate themselves from other candidates, by offering locally targeted programs. In contrast, high party unity decreases politicians' incentives for distributive politics. The more an individual politician's behavior is given by her party label and voters choose party labels than individual members of parliament, the fewer incentives politicians have to make localistic appeal in their electoral districts.

H2: the lower the party unity, the greater are the politicians' incentives to offer subsidies with narrow focus. The higher the party unity, the greater are the politicians' emphasis on broad subsidies.

The third factor is ideological distance between the major parties. Larger ideological distance between parties decreases incentives for distributive politics, because under such conditions, electoral competition will be based more on ideology than particularistic benefits (Franzese and Nooruddin 2003, 12-13). Political parties will differentiate themselves on the basis of ideology rather than their offers for particularistic benefits. In a political system with more distinct party ideologies, parties are expected to appeal less to pork-barrel, according to Franzese and Nooruddin, precisely because electoral competition in that system is more ideological. Lacking a "broader team on which to base competition, distributive politics come forward" in a system with less partisan polarization (Franzese and Nooruddin 2003, 13). Paddock (1998) similarly proposes that there are differences between party systems with ideological parties and hierarchically structured local parties. The latter system tends to be based on an incentive system of material, rather than purposive benefits (Paddock 1998, 765-6). According to Luch, parties organized around ideological goals are more likely to pursue "ideas, causes and the moralization of public policy" than "jobs, contracts, and advantages for supporters" (qtd. in Paddock 1998, 766). Applying this argument to subsidies, we expect

H3: the smaller the ideological distance between parties, the greater are the politicians' incentives to provide narrow subsidies. The larger the ideological distance between parties, the greater the emphasis on broad subsidies.

These three hypotheses suggest that the larger the district magnitude, the higher the party unity and the larger the ideological distance between parties in a country, the bigger the governments' emphasis on horizontal, or broad subsidies. The smaller the district size, the lower the party unity and the smaller the ideological distance between the parties, the more emphasis we would expect on narrowly targeted subsidies. In the rest of the paper, I test these hypotheses with data on spending on different types of subsidies in the European Union countries.

Research Design and Methodology

This paper explores the impact of district magnitude, party unity and ideological distance between parties on government's choice of methods to support businesses for 15 European Union members between 1992 and 2001.³ The countries and time period chosen is partly constrained by availability of data. However, the cases maintain variation on the variables of interests, district magnitude, party unity and ideological distance.

Among possible industrial support policies, such as tariffs, incentives and regulatory policies, this paper focuses on incentives to business. In the EU, tariffs and non-tariff barriers have gradually been eliminated. With the adoption of the Single European Act (1987), subsidies remained as one of the last means for governments to support their industries. Thus, this paper focuses on different types of subsidies as support to firms. My argument in this paper is that depending on the electoral incentives they face, governments can choose policies that provide benefits to a broad range of firms, or they can focus on a small number of firms. In order to

³ The countries (and time periods) that are included in this study are: Austria (1995-1998), Belgium (1992-1998), Denmark (1992-2000), France (1992-2001), Finland (1995-1998), Germany (1992-2001), Greece (1992-1999), Ireland (1992-2001), Italy (1992-2000), Luxembourg (1992-1998), the Netherlands (1992-2001), Portugal (1992-1997), Spain (1992-1999), Sweden (1995-2001) and the UK (1992-2000).

operationalize the breadth of government support, I use the two categories of state aid defined by the European Commission. The Commission categorizes subsidies according to their impact into horizontal and sectoral subsidies. Horizontal subsidies include subsidies to promote R&D, SMEs, for employment, training, the environment and subsidies that aim to narrow the gap between the poor and rich regions of the EU. Sectoral subsidies include subsidies to particular manufacturing sectors, coal, transport, and financial services. While horizontal subsidies affect a large number of firms in different sectors, sectoral subsidies target specific sectors, or even firms. I use these two categories of subsidies, horizontal and sectoral, as proxies for broadly targeted and narrow subsidies. The dependent variable in this study is the share of horizontal subsidies in total subsidies. Thus the larger the district magnitude, the higher the party unity and the larger the ideological distance between parties, the higher will be the share of horizontal subsidies in the total amount of subsidies granted by a government. The subsidy data are taken from the European Commission's electronic source *State Aid Scoreboard* (Commission).

District magnitude refers to the total number of legislators that acquire a seat in a given district. In this study, I use mean district magnitude, defined as the average number of representatives (rounded to the nearest whole number) elected by each electoral district for the lower legislative chamber. For party unity, I use a dummy variable indicating whether the electoral ballot system is closed or open list. When a system is based on closed lists, the party leaders exercise strong control over ballots, and the electoral faith of the candidate is tied to that of the party's. When voters can express their choices within a list, such as in an open list system, the candidate's electoral faith is more dependent on her personal reputation (Carey and Shugart 1995, 420-1). Admittedly, this is a very crude measure for the concept of party unity; however,

in the absence of alternative data, I use this measure in this paper.⁴ This variable takes on the value 0, when the country has a closed list system and 1 otherwise. The district magnitude and ballot data are taken from the Database of Political Institutions (Beck et al. 2001).

Finally, in order to measure ideological distance among the major parties, I use the left-right index variable created in the Comparative Manifestos Project (Budge et al. 2001). Left-right index is a summary measure of the position of a party on a left-right scale, calculated by combining values parties get on different dimensions identified by the project (such as planned vs. market economy) for each party in the Comparative Manifestos Project (Budge et al. 2001; Laver and Budge 1992). Using this index, I calculate the distance between the positions of the two major parties on the left-right scale. I define the two major parties as the two parties that got the highest share of the vote in the previous elections.

Results

The results of the OLS regression of the independent variables district magnitude, party unity and ideological distance on the dependent variable, horizontal subsidies, are presented in Table 1.

-----TABLE ONE ABOUT HERE -----

The results of the OLS regression show that all three variables are significant (district magnitude at 0.001 level, and party unity and ideological distance at 0.05 level of confidence). Two of the variables, district magnitude and ideological distance have the correct signs. The higher the district magnitude, the larger is the share of horizontal subsidies. Similarly, the larger the ideological distance between the two major parties in a country, the higher is the share of horizontal subsidies. The coefficient of the party unity variable is significant at high confidence

⁴ Suggestions for alternative measures will be appreciated. In future studies, I plan to either construct an ordinal scoring system similar to Carey and Shugart's (1995) system of "incentives to cultivate a personal vote", or hope to find a measure for EU countries similar to the Rice index used in the American politics literature.

levels; however, its sign is the opposite of what is expected theoretically. A change from a system of high party unity (closed list system) to low party unity (an open list system) leads to an increase in the percentage of horizontal subsidies, rather than a decrease. I propose above that a system with low party unity (with open list) creates incentives for politicians to promote their personal reputation in their electoral district by offering narrow, targeted subsidies. The regression analysis seems to suggest, to the contrary, that systems with low party unity are also those that spend a greater share of their total subsidy allocation towards horizontal subsidies.

In order to illustrate the effects of the independent variables on the dependent variable, I created plausible scenarios with these three variables. Table 2 shows the model's predicted values of horizontal aid, given the various values of the independent variable. For these scenarios, the remaining variables are set at their historical means and medians. The table shows that in a single member-district system, such as the UK, horizontal subsidies are 69.4% of total subsidies, while in a country with an average district magnitude of 20, such as Austria, 72.6% of subsidies will be horizontal. Ideological distance also has a positive impact on the types of subsidies. In a country with a low ideological distance between the two major parties, such as in the case of the Social Democrats and the Christian Social Party in Luxembourg between 1992-8, or the Italian Communists and the Christian Democrats in 1992-3, horizontal subsidies make up 68% of total subsidies. In a country with high ideological distance between the major parties, such as the Social Democrats and the Liberals (1994-2000) in Denmark, horizontal subsidies go up to 83% of total subsidies. Finally, in a country with a high party unity, 62% of subsidies are horizontal, while in a system with low party unity, 72.8% of subsidies are horizontal.

-----TABLE TWO ABOUT HERE-----

Lastly, Figure 1 shows the effects of the two continuous variables, district magnitude and ideological distance on projected levels of horizontal subsidies. District magnitude has a slight, positive effect on horizontal subsidy levels, and ideological distance has a stronger, positive impact.

-----FIGURE ONE ABOUT HERE-----

The regression analysis of the data on subsidies in the European Union support two of hypotheses proposed in this paper. In line with my expectations, high district magnitude and large ideological distance reduces politicians' incentives to provide narrowly targeted subsidies and increases their emphasis on broad subsidies such as subsidies for worker retraining, for SMEs, the environment, and R&D. Contrary to my expectations, however, high party unity does not increase politicians' incentives to provide broad subsidy measures. The regression analysis shows that a system with low party unity has more emphasis on broad subsidies compared with a system with high party unity. Further research would be useful to find a better measure of party unity, and to explore why party unity has the opposite effect of the theoretical expectations.

Conclusion

This paper explores the impact of electoral institutions on the governments' choice of instruments in supporting industries. I propose that high district magnitude, high party unity, and a large ideological distance between the major parties will lead politicians to offer financial and fiscal incentives that benefit broad sections of the society. In contrast, small district magnitude, low party unity and small ideological distance between the major parties create incentives for politicians to offer targeted, narrow subsidies to business. I test these hypotheses with data on two types of subsidies, horizontal and sectoral, in fifteen European Union members for the years 1992-2001.

The regression analysis supports two of the hypotheses. The variables district magnitude and ideological distance have a positive effect on the share of horizontal subsidies. Countries with high district magnitudes and large ideological distance between the major parties have a greater emphasis on subsidies that benefit broad segments of the society. Party unity has the opposite effect of what I propose in this paper. Party unity, measured as the impact of party leadership on who gets to be on the ballots and their ranking, has a negative impact on horizontal subsidies. A country with low party unity has more emphasis on broad subsidies than a country with high party unity. Further refinement of the theory and measurement is needed to establish how party unity influences politicians' incentives.

How do the findings of this paper contribute to the literature on comparative industrial policy? This paper suggests, in support of major claims in the literature on subsidies in OECD countries, that governments offer subsidies to businesses to increase their electoral chances. In addition, this paper suggests that electoral and party systems shape politicians' choices whether to provide targeted or broad support to their industries. Obviously, electoral institutions are not the only factors that affect this choice. The demand from businesses, the structure and concentration of the economy, and pressures from the international economy can influence the choice of policies. This paper establishes that electoral institutions influence politicians' incentives for providing targeted or broad measures of support for business. Further research can shed light on how these factors interact with one another and influence government policies.

The findings of this paper also contribute to the research on the impact of electoral institutions on economic and fiscal policies. One line of research in this literature explores the impact of party and electoral politics on politicians' incentives to provide targeted benefits. This paper tests some of the claims in that literature, and finds support for the arguments on district

magnitude and ideological distance. The argument about party unity, however, is disconfirmed. The empirical evidence in this line of literature has been limited so far. Using the types of subsidies governments offer to businesses, this paper contributes to the empirical research in this literature.

Finally, the findings of this study also provide some insights into the study and practice of what is called “state aid policy” in the EU. The European Commission, based on Articles 87-92 of the TEU, regulates the type and amount of all member state (and subnational) subsidies in the European Union. Especially since the late 1980s, the European Commission puts pressure on the member states to shift their emphasis from sectoral to horizontal subsidies, which the Commission argues is less harmful for competition in the single market, and more effective for increasing the global competitiveness of European firms. It is important to understand in this policy debate that part of the explanation for what types of subsidies the member states grant lies with electoral and party politics of each country. It is possible that the pressures from the European Commission can create incentives for politicians to grant broad subsidies, however, the findings of this paper suggests that the pace of change can be slow as long as electoral incentives are greater than the pressures of the European Union.

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TABLES AND FIGURES

Table 1: The results of the OLS regression of district magnitude, party unity and ideological distance on the share of horizontal subsidies.

Variable	Coefficient	Standard Error
District Magnitude	0.17	0.06
Party Unity	10.82	5.13
Ideological Distance	0.33	0.16
N= 117	Adjusted R(squared)= 0.07	

Table 2: Percentage of horizontal subsidies given the values on the independent variables. Other variables are held at their means or medians (District magnitude= 21.1, ideological distance= 16.6, and party unity = 1 (open list))

Value (percentage of horizontal subsidies)			
	High (district=20)	Medium (district=10)	Low (district=1)
District Magnitude	72.6	70.9	69.4
	High (distance= 47)	Medium (distance= 17)	Low (distance= 2)
Ideological Distance	83	73	68
	High (closed list)		Low (open list)
Party Unity	62		72.8

Figure 1: Predicted levels of horizontal aid. For these projections, other variables are set at their historical means or medians in simulations (district magnitude= 21.1, ideological distance= 16.6, party unity = high)

