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Who Gets What and Why?

The Politics of Particularistic Economic Policies

Democratic institutions ostensibly serve the common good. Yet democratically elected leaders face diverse incentives. Politicians must balance the public's welfare with demands from interest groups that run counter to the common good. Nowhere is this balancing act more apparent than in the area of economic policy. Governments' economic policies often redistribute resources between groups. Governments collect money from taxpayers and then spend the tax revenues on various programs. Governments may fund programs that support broad groups of citizens, such as health care or education. Alternatively, governments may use their fiscal resources to privilege small, select groups of citizens via programs like subsidies for business.¹ Subsidies typically provide economic benefits selectively to small groups and accordingly can be described as "particularistic" economic policies. Although particularistic economic policies often entail costs for many citizens, including taxpayers and consumers, they nonetheless emerge in democratic contexts.

Although the political motivations behind particularistic economic policies have been studied extensively,² the variation in such policies between countries is less well understood. Leaders in some democratic countries enact more particularistic economic policies than others and as a result, particularistic economic policies vary in both frequency and magnitude among democracies. In France and Australia, for example, leaders habitually provide narrowly targeted financial assistance to select businesses. Similarly, governments in the United Kingdom subsidized individual firms during the 1960s and 1970s, including state-

¹ Governments can also privilege select groups by exempting them from paying taxes.

² Producers' demands often prevail because they are fewer in number and consequently can organize more easily than taxpayers and consumers (e.g. Olson 1965, Alt and Gilligan 1994). Producers also have more at stake. Government subsidies can mean the difference between bankruptcy and profit. However, for taxpayers, the cost of any given subsidy program is negligible. Taxpayers consequently have few incentives to oppose subsidies.

owned companies like British Steel and British Airways (Sharp, Shepherd, and Marsden 1987). In contrast, during the same period, the West German government refused to provide subsidies to individual firms (Schatz and Wolter 1987). The government focused instead on building a comprehensive framework of policies that would benefit large numbers of citizens called the *Soziale Marktwirtschaft* (Sharp et al. 1987). Today, governments in some countries continue in the same tradition by providing general assistance to broad groups, as in Finland (Verdier, 1995: 4).

The diversity in democracies' economic policies reflects the varied responsiveness of politicians to different interests. In France, for example, most politicians believe it is their duty above all else to represent the citizens living in their geographically-defined electoral district.³ French politicians consequently work hard to secure economic benefits for their constituents. As one member of the French parliament (MP) colorfully put it, “[a]n MP is a gardener. He has a big garden – his constituency – and he has to go to Paris in order to get fertiliser.”⁴ Particularistic economic policies can provide such fertilizer.

In contrast, leaders in some countries strive to represent larger groups of citizens. In Sweden, for example, the government refused to bail out the ailing automotive industry following the 2008 global financial crisis. The Prime Minister said he would not put “taxpayer money intended for healthcare or education into owning car companies” (Ward 2009). The German government similarly resisted demands for industrial subsidies in the wake of the 2008 crisis. Defending this decision, the German Minister for Economics and Technology said that privileging certain industries went against “all successful principles of our economic policy.”⁵ Governments' varied approaches to economic policy highlight the puzzle motivating my book: why do governments provide more particularistic economic policies in some democracies than others?

The goal of this book is to understand economic policy. Specifically, I seek to explain the variation in economic support provided by democratically elected governments to firms, industries, and sectors, such as manufacturing. Understanding why governments do more to assist such groups in some countries is important. Democratic theorists have long worried about the power of special interests. Groups that pursue economic rents for themselves at the expense of others are of

³ In a survey conducted by Brouard et al. (2013), 41.2 percent of sitting French MPs said this.

⁴ Quoted in Brouard et al. (2013: 146). This quote came from a member of the centre-right political party Union for a Popular Movement (*Union pour un mouvement populaire*/UMP).

⁵ *The Economist* November 1, 2008: 62.

particular concern. Groups seeking government subsidies “not only pervert the meaning of democratic accountability but also create deadweight losses and distort economic incentives” (Cox and McCubbins, 2001: 48).⁶ The money governments spend on subsidies is money no longer available for other programs, such as education or health care. And governments facing tight budgets often cut programs, such as social welfare, in order to fund increased spending on subsidies (Rickard 2012b). Subsidies consequently have serious implications for the regressivity of government spending. It is therefore important to understand why leaders in some democracies spend relatively more on particularistic economic policies, like subsidies.

I argue that economic policy outcomes depend on the way politicians are elected and the distribution of economic activities in space. Economic policy cannot be explained by political institutions alone, contrary to conventional wisdom. Economic geography – that is, the geographic distribution of economic activities – must also be considered to understand governments’ economic policy decisions. My argument stands in contrast to “pure” institutional arguments that identify political institutions as the key determinant of countries’ economic policies (e.g. Persson and Tabellini 2003). This book’s core thesis is that economic policies result from the interactive effects of economic geography and political institutions, specifically the institutions governing democratic elections. Electoral institutions determine the optimal (re)election strategy for politicians and political parties competing in democratic elections. Economic geography determines which economic policies best accomplish the institutionally generated electoral strategy. In the following section, I briefly outline the contours of my argument, which I develop more fully in Chapter 3.

ARGUMENT IN BRIEF

Elections aggregate voters’ preferences. But not all elections work the same way. Different rules govern election contests in different countries. The rules governing elections, often referred to as electoral institutions or electoral systems, determine how elections work and ultimately how elections aggregate voters’ preferences. To understand the effects of electoral institutions, it is important to know what voters want. Equally important, however, is knowing where voters with shared preferences live. Voters with shared policy preferences may live close to one another in relatively small, geographically concentrated areas. But voters with shared policy preferences may alternatively reside throughout the

⁶ See also Stigler (1971) and Becker (1985).

country. Knowing where voters with shared policy preferences live is vital to understanding how electoral institutions shape policy outcomes because different electoral institutions provide dissimilar incentives for politicians to respond to groups with different geographic characteristics.

Voters' economic policy preferences depend, in part, on their economic security. Most voters work to earn a living and as a result, their personal economic prosperity is closely tied to the economic fortunes of their employer.⁷ People want their employer to be economically successful because successful industries hire and retain more employees, typically offering more generous wages and compensation packages (Aghion et al. 2011, Criscuolo et al. 2012, Stöllinger and Holzner 2016). Industries' ability to pay generous wages and provide secure employment opportunities often depends on governments' economic policies, including, for example, subsidies.

People employed in a given industry share a common interest in the economic performance of the industry and government policies that promote its performance.⁸ This shared interest is "narrow" because most industries typically employ only a small fraction of a country's total population. The US steel industry, for example, employs only 0.3 percent of the US population. The steel industry therefore constitutes a "narrow" or "special" interest, as defined here.

Narrow interests can be more or less geographically concentrated depending on the geographic patterns of employment. Although industries today have fewer constraints on where they locate and employees tend to be more geographically mobile, strong patterns of geographic concentration persist at both a national and regional level in many economies (Krugman 1991, OECD 2008, Autor, Dorn, and Hanson 2013). But not all industries are equally concentrated (Autor et al. 2013). While employees in the US steel industry are primarily located in just three of the fifty US states, the tourism industry, in contrast, employs people across the entire country. As these illustrative examples make clear, different industries have varied geographic patterns of employment.

Economic geography is politically important because politicians have varied incentives to cater to more or less geographically concentrated groups depending on a country's electoral institutions. Electoral institutions stipulate the rules governing elections and vary from country

⁷ In the short- to medium term. In the longer term, they may be able to move depending on their mobility and the costs of adjustment.

⁸ Citizens who own factors of production employed in the industry, such as capital or labor, also benefit.

to country. In some democracies, politicians can win office with less than a majority of votes. In others, a candidate's chance of winning office depends not on the number of individual votes they receive but rather on their value in office to party leaders. In short, the path to electoral victory is different in different countries depending on a country's electoral system.

Two main categories of electoral systems exist: plurality and proportional. In a plurality system, votes are cast for individual candidates and the candidate with the most votes wins office (Cox, 1990: 906). In contrast, proportional representation (PR) systems allocate legislative seats to parties in accordance with the proportion of votes won by each party. Together these two formulas govern eighty percent of elections held around the world (Clark, Golder, and Golder 2013, Inter-Parliamentary Union PARLINE database 2013).⁹

I briefly describe how economic geography matters in these two different systems. I develop my argument more fully in Chapter 3 where I identify two mechanisms through which economic geography and electoral institutions shape leaders' incentives and subsequently policy: (1) effective vote maximization and (2) the nature of electoral competition.

Geography in Plurality Systems

Politicians have incentives to cater to geographically concentrated groups in countries with plurality electoral systems because they must win a plurality of votes in their electoral district to win office. Politicians therefore court the support of groups concentrated in their own geographically defined district. To win their support, incumbent politicians provide economic benefits or "rents" to their district. By providing economic benefits to their constituents, politicians seek to develop their own personal support base among voters (i.e. a personal vote).

Politicians can use subsidies to develop a personal vote when the beneficiaries of the subsidy are geographically concentrated in their own district. When an industry's employees are concentrated in a politician's district, subsidies for that industry are analogous to legislative particularism, or "pork." The economic benefits of the subsidy go to the politician's district but the costs are spread over all taxpayers throughout

⁹ The PARLINE database can be found at www.ipu.org. The remaining 20 percent consist of "mixed" electoral systems that combine features of both plurality and proportional electoral systems. Germany, for example, has a mixed electoral system.

the country. Supplying such geographically concentrated benefits helps politicians cultivate their own personal support base among voters, which increases their reelection chances in plurality electoral systems (Ferejohn 1974, Fenno 1978, Wilson 1986).

Providing subsidies and other economic benefits to geographically concentrated groups is an expedient way to win elections in plurality electoral systems. As a result, particularistic economic policies for geographically concentrated groups are common in countries with plurality electoral systems. In the United States, for example, the Republican-led administration imposed a 30 percent tariff on steel imports in 2002 in an attempt to win Congressional seats in the steel-producing states of Ohio and Pennsylvania (Read 2005).¹⁰ In 2017, President Donald Trump launched an investigation of foreign steel imports in order to fulfil a campaign promise he made to steel workers in two important swing states: Ohio and Pennsylvania. Trump launched the investigation under Section 232 of the Trade Expansion Act of 1962, which empowers the Department of Commerce to decide whether imports “threaten to impair” US national security and gives the president substantial autonomy to impose new trade barriers (Bown 2017). Trade barriers imposed on foreign steel imports would benefit the geographically concentrated steel industry and its employees. At the same time, however, they would increase costs for US manufacturers and construction companies that rely on imported steel inputs, ultimately raising costs for US consumers and also taxpayers who fund public infrastructure projects.

Despite their costs, particularistic economic policies – or even just the promise of them – provide a useful electoral tool in plurality systems when the beneficiaries are geographically concentrated. Particularistic economic policies allow parties to target benefits to precisely those areas where they most need increased voter support, such as Ohio and Pennsylvania in the United States example. In contrast, when the beneficiaries are geographically diffuse, particularistic economic policies are an inefficient means to win plurality elections. If the US steel industry had been more evenly dispersed within the country, for example, providing the industry with economic benefits would have “over bought” support in some states where the Republican party did not need any additional votes to win. For this reason, neither political parties nor individual politicians have strong incentives to provide economic benefits to geographically diffuse groups in plurality systems. For political parties, supporting diffuse groups will over buy support in some areas and under buy support in others. And

¹⁰ The US risked violating their obligations as a member of the World Trade Organization by supplying these tariffs to the steel industry.

individual politicians seeking an office other than the presidency need to win only the support of voters in their own electoral district. As a result, few incentives exist to work on behalf of geographically diffuse groups spread across many districts in plurality systems because doing so neither sufficiently rewards politicians' efforts nor maximizes their chances for (re)election.

Geography in Proportional Systems

Geography is unimportant for political parties competing in countries with proportional electoral systems and a single, national electoral district. In such systems, all votes are equally valuable because they all contribute to a party's share of the national vote, regardless of their geographic location. A party's national vote share determines how many seats they hold in the legislature. Parties want to maximize the number of legislative seats they hold, and to this end they work to maximize their share of the national vote. They can do so with little regard for the geographic distribution of potential supporters because the entire country constitutes a single electoral district. In reality, however, single district PR system are rare. Only a handful of PR countries have one nationwide electoral district. Instead, most PR systems have multiple subnational districts.

Geography matters in PR systems with multiple electoral districts. In such systems, most legislative seats are awarded to parties based on their district performance rather than their national performance. In Norway, for example, 150 of 169 legislative seats are allocated to parties based on their share of district votes (Aardal 2011).¹¹ As a result, the geography of potential votes is electorally important in countries with proportional electoral systems and multiple districts. Political parties competing in such countries consequently take economic geography into account when making policy decisions. However, unlike parties in plurality systems, political parties in PR systems tend to favor geographically diffuse groups. Providing economic benefits to geographically diffuse groups maximizes parties' effective votes and the likelihood of being in parliament.

Parties competing in proportional systems with multiple district are better off supplying policies to geographically diffuse groups rather than

¹¹ Because seats are awarded to parties at the district level, we observe disproportionality between parties' national vote shares and the number of legislative seats they hold in most PR countries. Such disproportionality has been the subject of extensive research including, for example, Gallagher (1991).

concentrated groups for several reasons. First, favoring geographically diffuse groups helps parties build a nationwide constituency. A nationwide constituency is electorally useful in proportional systems and particularly in PR systems where elections are party centered. A nationwide constituency helps parties grow their vote share and “displaces the district as the primary electoral constituency” (Lancaster and Patterson, 1990: 470).¹² Displacing the district as the primary electoral constituency gives the party greater influence over their legislators because legislators are less able to appeal to their district-level constituents for reelection. Parties with greater control over their legislators have relatively greater influence on policy outcomes, which permits them greater opportunities to provide benefits to diffuse groups. Such benefits can engender “a shift in the national mood towards the ruling party” (Reed, Scheiner, and Thies 2012), which increases the party’s vote share and the number of seats they control in the legislature.

Second, political parties have incentives to pursue the support of geographically diffuse groups to ensure that the party’s vote share is above any national vote-share threshold, which exist in many PR systems. These thresholds stipulate that political parties must win a minimum share of the national vote to hold any seats in parliament. Parties that pursue the support of geographically concentrated groups rather than geographically diffuse group may fail to cross national vote-share thresholds. In Norway, for example, a party called People’s Action Future for Finnmark (*Folkeaksjonen Framtid for Finnmark*) focused exclusively on improving the economic conditions in Finnmark. To this end, the party campaigned on increasing government assistance for the area’s fishing industry (Aardal 2011). The party subsequently won 21.5 percent of the vote in the electoral district of Finnmark in 1989 (Aardal 2011). However, the party won just 0.3 percent of the national vote and as a result it was not eligible for any of the legislative seats allocated at the national level because it failed to clear the national threshold of 4 percent. As this example illustrates, parties competing in PR systems have compelling incentives to pursue diffuse votes spread across the country.

Third, parties in PR systems may support geographically diffuse groups in an attempt to generate a more uniform vote swing – that is, a similarly sized vote increase in all districts. A more uniform swing often produces more seats for parties competing in PR systems with multiple districts. Because a more uniform swing potentially increases a party’s legislative

¹² “Thereby decreasing the importance of pork-barrel politics” (Lancaster and Patterson, 1990: 470).

seats, parties have electoral incentives to favor geographically diffuse groups.

These reasons explain why geographically diffuse groups receive support from political parties competing in PR systems. But why would parties in PR systems provide fewer subsidies to concentrated groups than diffuse groups? The answer is simple: subsidies entail costs. These costs include both real monetary costs and opportunity costs. Every dollar spent on subsidies for concentrated groups is one less dollar available for diffuse groups. The opportunity costs of forgone spending on diffuse groups are large for political parties competing in PR systems. Subsidizing the geographically diffuse construction industry, for example, helps people in all regions of the country. Employees in the construction industry benefit directly from subsidies via increased wages and more secure employment. Owners of capital invested in the industry benefit from above market rates of return and greater demand. Related sectors, such as real estate and retail, also benefit from government-funded subsidies for the construction sector. And because the sector is geographically diffuse, many more people in related sectors indirectly benefit from government support. Real estate agencies, restaurants, and hardware stores across the country benefit from government aid to the diffuse construction sector. If the sector was concentrated in a single area, many fewer people in related sectors would benefit – potentially just a handful of real estate agents, restaurants or hardware stores in a single city. More people, in more places, benefit from subsidies to geographically diffuse groups.

Subsidies to geographically diffuse industries typically benefit more people than subsidies to equally sized concentrated industries. In effect, there is a “dispersion bonus” from subsidizing geographically diffuse industries.¹³ This dispersion bonus is more valuable electorally for parties competing in PR systems than parties in plurality systems. In PR systems, every additional vote won by a party contributes to its electoral success. In contrast, many of the additional votes secured via subsidies are lost to parties and politicians competing in plurality systems. As a result, governments in PR systems will tend to spend more on geographically diffuse groups than governments in plurality systems, all else equal. Even relatively small, geographically diffuse groups can win subsidies in PR systems because more votes translate into more seats. In Norway, for example, the Liberal Party (*Venstre*) could have won seven seats instead of two if it had won just 0.1 percent more of the national vote in the 2009 election (Aardal 2011). Providing subsidies to an industry employing just

¹³ I am grateful to John Carey for articulating the term “dispersion bonus.”

0.1 percent of the country's labor force could have made a big difference to the Liberal Party's electoral fortunes.

Because the electoral support of geographically diffuse groups is especially valuable for parties competing in PR systems, diffuse groups can and do win particularistic economic policies. In Sweden, a country with a proportional electoral system, the geographically diffuse forestry sector received 10 percent of all government subsidies – despite the fact that it employed less than 1 percent of the country's total population (Carlsson 1983).¹⁴ Similarly, in Norway, which also has a PR system, the geographically diffuse tourism industry receives generous state support. In 2013, for example, the Norwegian government made a deal with Disney regarding the marketing of the film *Frozen*. For an undisclosed amount of money, the Norwegian government secured exclusive rights to use creative elements from the film, as well as the Disney logo and brand, in the marketing of Norway as a travel destination (Innovation Norway 2014a). The deal is credited with significantly increasing tourist numbers. Fjord Tours' sales in the American market doubled in the beginning of 2014, and ticket sales on the Hurtigruten coastal express increased by 24 percent (Innovation Norway 2014a). The upsurge in tourism brought economic benefits to businesses throughout the country.

In sum, my argument brings together electoral institutions and economic geography and shows how they interact to shape economic policy. I argue that both plurality and proportional electoral systems incentivize the provision of narrowly beneficial, particularistic economic policies under certain conditions. Leaders in plurality systems have incentives to supply particularistic economic policies when the beneficiaries are geographically concentrated. When the beneficiaries of particularistic economic policies are geographically diffuse, leaders in PR systems have incentives to supply such policies.

CONTRIBUTION

By bringing together geography and institutions, my argument provides a solution to the ongoing debate over which democratic institutions make governments most responsive to narrow interests. Purely institutional accounts reach conflicting conclusions about the effects of electoral systems on leaders' responsiveness to narrow interest groups. In the following section, I briefly outline the contours of the ongoing debate.

¹⁴ During the mid-1970s.