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Conclusion and Implications

This book examines why elected leaders in some democracies are more responsive to special interests than other. Leaders' responsiveness to interest groups depends on a country's electoral institutions and economic geography. Electoral institutions generate (re)election incentives for politicians and political parties and economic geography determines the optimal policy with which to respond to these incentives. As a result, economic geography mediates the effect of electoral institutions on policy outcomes.

Although economic geography plays an important role in policy making, many previous studies overlook the geographic distribution of economic activity. Purely institutional arguments posit a direct relationship between electoral institutions and policy outcomes. Because of the ubiquity of such arguments, it has become almost trivial to say that "institutions matter." Institutions certainly matter; however, their effects on economic policy are indirect. Electoral institutions generate (re)election incentives but economic geography determines the optimal policy with which to respond to these incentives. As a result, identical electoral institutions can produce different policy outcomes depending on patterns of economic geography.

In this book, I develop and test my argument in the context of economic policy. Economic policies that selectively assist small groups of citizens at the expense of many, such as government-funded subsidies, are my primary focus. Subsidies help people employed in a subsidized industry by raising wages and safeguarding stable employment, but they do so at the expense of taxpayers who ultimately fund such programs. In this way, subsidies redistribute wealth between groups of citizens in a country. Governments' decisions about subsidies reveal their political priorities. Governments that allocate more of their budgets to industrial subsidies are more willing to privilege small, narrow groups of voters over larger groups.

Money spent on industrial subsidies is money no longer available for health care or education. However, some governments instead prioritize programs that benefit larger groups of citizens at the expense of subsidies. The Swedish Prime Minister, for example, refused to fund subsidies for the automotive industry stating that he would not put "taxpayer money intended for healthcare or education into car companies" (Ward 2009). In this case, the Prime Minister explicitly prioritized broadly-beneficial programs like education over a narrowly-beneficial subsidy program. Yet, leaders in different countries make different policy decisions. The question is why. What explains the cross-national variation in government spending on subsidies? This variation is puzzling given existing institutional theories (e.g. Persson and Tabellini 2003). Why do governments in countries with identical electoral institutions exhibit varied spending priorities?

Governments elected via similar institutions spend dissimilar amounts on subsides because the usefulness of subsidies as an election-winning policy tool depends on economic geography. Economic geography refers to the geographic distribution of economic activity. The geographic distribution of economic activity determines the location of the beneficiaries of government-funded subsidies. If the beneficiaries are dispersed across many electoral districts, subsidies are an inefficient electoral tool in plurality systems where elections are won district-by-district. If the beneficiaries are geographically concentrated in a single district, a subsidy is roughly analogous to legislative particularism, or "pork barrel" spending. Bringing "pork" home to their own district helps politicians cultivate a personal base of support among voters in their district, which increases their reelection chances in plurality systems (Ferejohn 1974, Fenno 1978, Wilson 1986). As a result, geographically-concentrated groups tend to win more generous subsidies in countries with plurality electoral rules, all else equal.

Geographically diffuse industries win relatively greater subsidies in countries with proportional electoral systems. Subsidies for diffuse industries are politically expedient in PR systems where parties win legislative seats in proportion to their vote share. To maximize their vote share, parties supply subsidies to geographically diffuse groups. A subsidy to a geographically diffuse industry, for example, indirectly benefits more people than a subsidy to a concentrated industry. Subsidies help not only those people directly employed in an industry but also people working in related industries, such as retail and services. Subsidizing the geographically diffuse construction industry, for example, helps people employed in real estate, timber yards, and restaurants across the country. Because of these positive spillover effects, there is a "dispersion bonus" from subsidizing geographically-diffuse industries and the political profit from this dispersion bonus is greater in PR systems than in plurality systems.

EMPIRICAL CHAPTER OVERVIEW

In Chapter 4, I investigate the variation in government spending on manufacturing subsidies between democratic countries. Quantitative statistical tests confirm that electoral institutions and economic geography work together to explain the variance in manufacturing subsidies between democratic countries. Governments elected via plurality systems spend relatively more of their budget on subsidies when the beneficiaries are geographically concentrated. When subsidy recipients are geographically diffuse, governments in PR systems spend relatively more money to subsidize them, all else equal. These results are robust to alternative model specifications including those that relax the assumption that electoral systems are exogenous.

Chapter 5 provides qualitative evidence linking electoral institutions, economic geography, and economic policy. In this chapter, I examine two subsidy programs in countries with very different electoral institutions: Austria and France. In France, candidates win office by obtaining a majority of votes in the first ballot or failing that, a plurality of votes at the second ballot (Elgie 2005). Because of this electoral system, subsidies in France tend to go to geographically-concentrated groups (Verdier 1995),[1] as illustrated by the subsidy program examined in Chapter 5. Only producers located in a small, well-defined geographic area (i.e. approximately 1,000 hectares in the Cognac region) received financial assistance via this program. Legislators who represented the area, including those from different parties, pushed for the selective subsidy. Their demands were ultimately successful and the French government subsidized Cognac producers in violation of EU state aid rules.

While the French subsidy was highly selective and available only to producers in a concentrated geographic area, the Austrian subsidy, in contrast, was broadly beneficial and available to all farm-gate wine merchants regardless of their geographic location. Austrian farm-gate wine merchants, who benefited from the subsidy program, were spread

[1] Subsidies for geographically-concentrated groups are generously funded by the French government. In 2013, for example, subsidies equaled 0.6 percent of GDP in France.

across more than forty-five thousand hectares in Austria.[2] Subsidizing a geographically diffuse group like farm-gate wine merchants is politically expedient for parties competing in a country where elections are held via proportional electoral rules and closed-party lists. Because of the institutionally generated incentives that Austrian leaders faced, the government provided this subsidy to a geographically-diffuse producer group even though it violated EU state aid rules.

The French and Austrian examples demonstrate that the electoral incentives to subsidize producers sometimes outweigh the costs of violating international rules. The domestic incentives to supply subsidies are greatest when electoral institutions and economic geography align. Together, electoral institutions and economic geography predict the likelihood that an EU member-country will subsidize producers in violation of EU state aid rules, as demonstrated in Chapter 5. Illegal (i.e. noncompliant) subsidies are more likely in PR systems than plurality systems when the beneficiaries are geographically diffuse. Arguably this is because the electoral incentives to supply subsidies to diffuse groups are relatively larger in PR systems. When the potential electoral benefits are large, governments are willing to provide subsidies in violation of international economic agreements.

In Chapter 6, I examine government spending on subsidies in countries with proportional electoral systems. I examine the variation in subsidies both within and between PR countries. Looking at subsidies within a single PR country, I find that geographically diffuse sectors win more generous subsidies than geographically concentrated sectors, all else equal. This evidence demonstrates that the electoral support of geographically-diffuse groups is especially valuable in PR systems.

In all PR systems, the political bonus from subsidizing geographically diffuse groups is electorally valuable, and as a result, spending on subsidies is higher in PR systems when the beneficiaries are more diffuse. However, spending on geographically diffuse groups is relatively higher in closed-list PR systems, as compared to open-list PR systems. In open-list systems, some funds are diverted by powerful individual legislators to groups that are geographically concentrated in their own electoral district or bailiwick (Ames 1995, Golden and Picci 2008). Legislators in open-list PR systems have incentives to divert resources in this way to cultivate their own personal support base. Doing so helps them win more individual votes and consequently increases their reelection chances. As a result, spending on subsidies for geographically diffuse groups is relatively higher in closed-list PR systems where political parties can better

[2] Data from www.bmlfuw.gv.at.

discipline their legislators to ensure subsidies flow to geographically diffuse groups.

The difference between open-list and closed-list systems highlights an important mechanism linking electoral institutions, economic geography, and policy outcomes: the nature of electoral competition. Open-list systems engender candidate-centered elections because candidates must work to differentiate themselves from co-partisans in order to win preference votes. To do this, candidates highlight their own personal qualifications and work to (or promise to) provide select benefits to their district or bailiwick. The candidate-centered nature of elections in open-list systems, as in plurality systems, incentivizes the provision of economic benefits to geographically concentrated groups. These incentives grow stronger as district magnitude increases and politicians compete against even more co-partisans for voters' support. Among PR systems, the most generous subsidies occur in open-list systems with high mean district magnitude and geographically concentrated groups, as shown in Chapter 6. This finding demonstrates that the nature of electoral competition is an important mechanism linking electoral systems and economic geography to policy outcomes.

In Chapter 7, I investigate the variation in subsidies between electoral districts within an archetypal PR country: Norway. Two novel results emerge from this single-country study. First, political parties competing in closed-list proportional electoral systems engage in policy targeting – that is, they supply benefits to select, geographically defined groups. Second, political parties in this de facto closed-list PR system target economic benefits disproportionality to districts where they have relatively more supporters. Controlling for economic geography, districts where the largest government party won a greater share of the votes in the previous election receive more generous subsidies, all else equal. Government parties in this PR system use subsidies to consolidate the partisan advantage that helped them win seats in the first place by subsidizing producers in "safe" districts.

Chapter 7 also includes novel qualitative evidence from interviews of government ministers and bureaucrats responsible for subsidy programs. These interviews confirm the importance of electoral politics and economic geography for governments' spending decisions. The interviews also illustrate the mechanisms that governments use to target subsidies to politically important areas. In Norway, the government targets subsidies in at least two ways. First, the government decides how much money to spend on subsidies for each sector of the economy. Via the budget process, the government directly controls the allocation of subsidies to economic sectors, including agriculture and manufacturing. Second, the government indirectly controls the allocation of subsidies to firms within a given sector via control of the bureaucracy. To control bureaucratic decisions over firm-level subsidies, the government uses various mechanisms including letters of assignment and biannual meetings. These mechanisms of control exist because political parties care about the outcomes of bureaucratic behavior (Huber, Shipan, and Pfahler 2001). Bureaucratic decisions regarding subsidies are especially important because subsidies help political parties win votes and subsequently legislative seats (Buts et al. 2012).

CONTRIBUTIONS

This study makes several important contributions. First, it suggests a solution to the ongoing debate over which democratic institutions lead politicians to be the most responsive to special interests. Research on this topic has reached something of a stalemate. Theoretical models make competing predictions and empirical studies find conflicting results. Some studies find that particularistic policies are more frequent in plurality electoral systems. Yet others show that proportional electoral systems generate more particularistic economic policies than plurality systems. Although evidence continues to accumulate on both sides of the debate, no study has yet offered a solution for this impasse. I suggest a straightforward explanation for this gridlock: economic geography.

Most accounts of institutions' policy effect ignore economic geography. Others make highly restrictive assumptions about the geographic distribution of voters with shared policy preferences. For example, some scholars assume that voters employed in a given industry are entirely concentrated in a single electoral district (e.g. McGillivray 1997, Grossman and Helpman 2005). Yet, in reality, an industry's employees may be more or less geographically diffuse. As illustrated in Chapter 4, improved data transparency makes it possible to empirically measure the geographic distribution of voters employed in the same industry or sector. As a result, it is no longer necessary to make simplifying assumptions about where industries or their employees are located. Instead, their actual geographic distribution can be measured empirically – albeit for a limited number of countries.

Relaxing the restrictive assumptions about economic geography reveals new predictions about electoral institutions' policy effects. Both plurality and proportional systems generate particularistic economic policies in certain cases – it depends on the geographic concentration of voters with shared economic interests. By accounting for the variation exhibited in the spatial patterns of economic activity both within and between countries, my argument provides a bridge between two competing arguments and specifies the conditions under which one is more appropriate than the other.

In addition to taking economic geography seriously, my research also suggests several further ways to advance our understanding of the policy effects of electoral institutions. Understanding how electoral institutions – a fundamental feature of democracy – influence policy outcomes is important. Doing so brings new evidence to key questions at the heart of democratic politics including questions about responsiveness and representation. To advance our understanding of the policy effects of electoral institutions, I move beyond the blunt dichotomy between plurality and proportionality in Chapter 6 to explore the institutional variation that exists among PR countries. The findings reported in Chapter 6 suggest that the widespread use of the plurality/PR dichotomy obscures an important mechanism linking electoral institutions to policy: the nature of electoral competition. Electoral competition can be characterized as being either candidate-centered or party-centered. Party-centered competition encourages voters to emphasize their party preference over that for specific candidates. In contrast, candidate-centered competition encourages voters to see the basic unit of representation as the candidate rather than the party.

The PR/plurality dichotomy obscures the effects of electoral competition because the nature of electoral competition does not line up with the PR/plurality distinction. A country's electoral formula alone does not determine the nature of electoral competition. Instead, the constellation of institutions that make up a country's electoral system shape the nature of electoral competition. Proportional electoral formulas, for example, do not always generate party-centered elections. Elections in some PR systems are, in fact, candidate-centered. Open party lists generate candidate-centered electoral competition and elections in open-list PR systems are particularly candidate-centered when district magnitude is high. In sum, various features of a country's electoral system work together to shape the nature of electoral competition. This observation cautions against using only the blunt PR/plurality dichotomy to study the policy effects of electoral institutions.

Further confusion about the policy effects of electoral institutions stem from poor measures of particularistic economic policy. It is difficult to determine precisely which government programs should be classified as "particularistic" or narrowly-beneficial. Indeed, many existing studies struggle with this challenge (e.g. Cox and McCubbins 2001, Hatfield and Hauk 2014, Milesi-Ferretti, Perotti, and Rostagno 2002). My research suggests a novel way to classify government programs by looking at the number and geographic distribution of potential beneficiaries. In Chapter 4, I demonstrate how to estimate the geographic dispersion of an industry's employees using entropy indices. While this strategy is data intensive, it allows researchers to more accurately characterize government programs as being either "broad" or "narrow." Improving measures of particularistic economic policies using the strategy I employ here may help to clarify the policy effects of electoral institutions.

My argument makes two additional contributions of note. First, it adds an important new element to neoinstitutional theories in political science. These arguments contend that institutions aggregate preferences and acknowledge the importance of voters' preferences. However, it matters not only what voters want from government but also where they are located. Voters with shared preferences can be more or less geographically concentrated and their geographic patterns may change over time, particularly in an era of increased geographic mobility. Different electoral institutions create varied incentives for leaders to respond to geographically concentrated (or diffuse) groups. Therefore, geography must be part of any institutional story.

Second, my research contributes to understanding the political consequences of geographic concentration. Previous studies show that geographic concentration is a political asset in plurality systems, helping industries to win greater trade protection, for example. However, the role of geographic concentration in proportional systems remained unknown to date. This book provides one of the first quantitative test of the effects of geographic concentration between countries with varying electoral systems. The results reveal that the effects of geographic concentration vary across different electoral systems. In plurality systems, geographic concentration is a political asset. More concentrated groups win relatively more generous government subsidies, all else equal. However, geographic concentration is not always a political asset. In proportional systems, geographic concentration is, in fact, a political liability. Geographically concentrated groups win fewer subsidies than diffuse groups in PR systems, all else equal. This evidence challenges the long-held conventional wisdom that geographic concentration is politically valuable for interest groups.

BEYOND SUBSIDIES

I develop my argument in the context of economic policy and subsidies in particular. However, the logic of my argument is general and can be applied to a range of other issues. My argument provides useful insights whenever voters with shared preferences exhibit varied geographic patterns between and/or within countries. One example may be ethnic politics (Horowitz 1985, Mozaffar et al. 2003, Lijphart 2004). Members of an ethnic group may share common policy preferences. If so, my argument suggests that the influence of an ethnic group's preferences on policy will depend on the country's electoral institutions and the group's geographic distribution. When an ethnic group is geographically diffuse, their preferences will have greater expression under proportional electoral rules than plurality rules. In such a situation, it may be inopportune to introduce plurality electoral rules – particularly in an ethnically diverse society. Of course, future research is needed to determine the extent to which my argument applies to ethnic politics but it suggests one promising application beyond economic policy.

My argument cautions that institutions alone cannot guarantee a particular policy outcome. Policy is shaped by the interaction of institutions and geography and as a result, no specific institution can guarantee a desired policy outcome. Understanding that political institutions alone do not determine policy outcomes has important implications for constitutional designers and reformers. To correctly anticipate the policy effects of a particular institution, constitutional designers need to know the geographic patterns of politically relevant groups.

My argument also suggests a novel explanation for why government spending on social welfare tends to be higher in PR countries than plurality countries. In short, social welfare beneficiaries tend to be geographically diffuse (Persson and Tabellini 2003). Their geographic diffusion gives them greater political influence in PR countries as compared to plurality countries.[3] In this way, economic geography may help to explain why social welfare spending tends to be higher in PR systems than plurality systems – a question that has long intrigued many scholars.

Unemployed persons also tend to be geographically diffuse across a country. This pattern may help to explain why governments in PR countries tend to spend more on programs available to all unemployed persons, such as unemployment insurance, training, and job search assistance (Persson and Tabellini 2003). Leaders in plurality countries are not immune to concerns about unemployment. However, they tend to fund more selectively targeted unemployment programs. In the United States, for

[3] Others have suggested that this pattern emerges because PR systems favor left-leaning parties (Iversen and Soskice 2006, Rodden unpublished manuscript). While this mechanism may be at work, my argument suggests another possible mechanism: geography.

example, the federal government funds a program called Trade Adjustment Assistance (TAA) that aids people made unemployed by foreign trade (Rickard 2015). TAA benefits are selective and the eligibility criteria are strict. Workers must demonstrate that they lost their job as a direct result of foreign trade.[4] Workers displaced because of international trade tend to be geographically concentrated (OECD 2007). In fact, workers made unemployed by foreign trade are frequently more concentrated geographically than the population of unemployed persons (Autor et al. 2013). The geographic concentration of trade-displaced workers helps to explain why they receive selective unemployment benefits in countries with plurality electoral systems, like the United States. Governments in plurality systems have electoral incentives to assist geographically concentrated groups. As a result, they will augment general assistance programs with targeted, specific support programs when there are geographically concentrated job losses (OECD 2007). The benefits of the United States' TAA program, for example, go to geographically concentrated groups – often workers formerly employed in a single firm.[5] Although the United States' TAA program is relatively unique, other countries with candidate-centered elections also fund targeted assistance programs, including, for example, Mexico's Sectoral Promotion Programs (PROSEC) and Japan's System for Revitalizing Industrial Competitiveness. These programs selectively target aid to industries and regions where trade-induced unemployment is high. By funding assistance specifically for trade-displaced workers, leaders help geographically concentrated groups. For politicians in plurality systems, the electoral benefits from providing such targeted assistance are relatively large.

INTERNATIONAL IMPLICATIONS

Beyond implications for domestic politics, my argument also has important implications for international politics. First, my argument

[4] Consequently, only a small number of people benefit from the TAA program. In 2007, for example, the United States spent $855.1 million dollars to assist approximately 150,000 workers under the TAA program (Reynolds and Palatucci 2012) and in 2010, the program helped just 199,238 people (Dolfin and Schochet 2012).

[5] See Reynolds and Palatucci (2012) and https://doleta.gov/taaccct/pdf/TAACCCT_Maps_DH.pdf. Firms must first be certified as being eligible for the TAA program (Reynolds and Palatucci 2012). To be certified, groups of workers or their representatives file a petition with the Employment and Training Administration of the U.S. Department of Labor (USDOL). Once a firm is certified, workers laid off from the firm are then eligible for TAA benefits (Reynolds and Palatucci 2012).

suggests which countries are most likely to violate international economic agreements. Second, my argument identifies the countries most likely to impede future international economic integration. Third, my research identifies the countries most likely to demand reform to existing international economic agreements. I briefly discuss each implication in turn.

Violating International Economic Agreements

Some international economic agreements limit governments' ability to subsidize domestic producers. The WTO Agreement on Subsidies and Countervailing Measures (also known as the Subsidies Agreement or the SCM Agreement) establishes rules regulating the use of subsidies. The WTO's subsidy rules are enforceable through binding dispute settlement, which specifies strict time lines for bringing an offending program into conformity with WTO member-states' obligations (Davis 2012). The European Union's State Aid rules also limit certain types of subsidies. These rules are enforced by the European Commission, which can order a member state to recover aid granted to beneficiaries under an illegal subsidy scheme.[6]

In many countries, elected leaders are consequently caught between a rock and a hard place. They have domestic electoral incentives to provide subsidies but at the same time, international rules limit their ability to subsidize domestic producers. And violating international subsidy rules entails costs. Caught in this double-bind, what do leaders do? I argue that leaders will violate their international treaty obligations when the electoral benefits of doing so outweigh the costs. The electoral benefits are most likely to outweigh the costs when the incentives generated by a country's electoral institutions align with economic geography. As I have argued, subsidies bring large electoral benefits to leaders in plurality countries when the beneficiaries are geography concentrated. When beneficiaries are geographically diffuse, subsidies bring relatively greater benefits to parties in PR systems. When the incentives generated by a country's electoral institutions align with economic geography, leaders have powerful incentives to supply subsidies and these incentives may be sufficiently large to cause them to violate international subsidy rules.

[6] Recovery includes interest on the subsidy amount at an appropriate rate fixed by the Commission. Although these costs are substantial, the penalties for acting against EU subsidies rules are not always severe enough to deter "illegal" subsidies (Martin and Valbonesi 2008). On June 30, 2014, there were forty-nine active pending recovery cases.

This assertion is supported by evidence presented in Chapter 5, which shows that violations of EU state aid rules depend, in part, on a country's electoral institutions and economic geography. Politicians elected via proportional electoral rules are more likely to subsidize geographically diffuse sectors in violation of EU state aid rules than politicians elected via plurality rules. In other words, governments in PR systems provide more "illegal" (i.e. non-EU compliant) subsidies than governments in plurality systems when the beneficiaries are geographically diffuse. Further evidence of this pattern comes from the Austrian subsidy for farm-gate wine merchants discussed in Chapter 5. The Austrian legislature, whose members are elected via proportional rules from de facto closed party lists, supplied assistance to farm-gate wine merchants spread across all of the country's winemaking regions. The Austrian government violated EU state aid rules to subsidize this geographically diffuse group because the electoral benefits of doing so were large.

Resistance to New International Rules

Governments often have electoral incentives to subsidize domestic producers. Yet, compelling reasons exist to agree to international restrictions on subsidies. Countries are better off if they can reach and enforce an agreement to forgo subsidies funded in the prospect of poaching each other's profits in imperfectly competitive markets (Dewatripont and Seabright 2006).[7] Agreeing to international subsidy restrictions may help countries avoid wasteful, and often escalating, "subsidy wars" (Dewatripont and Seabright 2006). Subsidy wars can be costly and protracted, as illustrated by the experience of the large civil aircraft industry. This industry is dominated by two firms: Airbus and Boeing. Airbus was created by a group of European nations to rival the American firm Boeing. Airbus received generous financial assistance from its' member nations. They justified their financial assistance by citing the high barriers to entry in the capital-intensive aircraft industry (Kienstra 2012). Due in part to the European governments' largesse, Airbus eventually overtook Boeing's position as the leading producer of large civil aircraft (Kienstra 2012). The United States government responded by providing generous financial assistance to Boeing.

[7] In fact, the logic behind international restrictions on subsidies builds on "strategic trade policy" where countries compete with each other in a game of individually rational but collectively wasteful subsidies to industry, spurred by the prospect of poaching each other's profits in imperfectly competitive markets (Brander and Spencer 1985).

The firm received an array of subsidies from different government agencies including America's space agency, NASA, and the Export-Import Bank of the United States (sometimes referred to by critics as "Boeing's Bank"). These subsidies brought the United States into conflict with the European Community, which reached a head in 2004 when the United States filed a formal complaint with the World Trade Organization over subsidies provided by the European Community to Airbus. The European Community responded by filing a parallel complaint regarding subsidies provided to Boeing by the United States. The European Community claimed that Boeing benefited from illegal subsidies worth $19.1 billion between 1989 and 2006.[8] The dispute remains ongoing; the most recent action, a panel report, was circulated in September 2016. As this case illustrates, subsidy wars can be costly and drawn out. Countries therefore have incentives to agree to (and comply with) international rules regulating subsidies.

These international incentives, however, must be weighed against the domestic electoral benefits from providing subsidies. Governments may want to provide subsidies to domestic producers in order to reap the electoral benefits. In this case, governments may resist further international restrictions on subsidies. More international rules mean governments will have fewer opportunities to use subsidies to win elections. As shown in Chapter 5, governments may flout international rules and provide subsidies in violation of international economic agreements when the electoral benefits of doing so are large. But violating international rules is costly. The Italian government was ordered to recover illegal aid amounting to €15 million from hotel companies in Sardinia by the European Commission in 2008. Seven years after the order, only €2 million of the initial €15 had been recovered. In 2015, the Commission asked the European Court of Justice to impose a lump sum penalty of €20 million, in addition to a daily penalty payment of €160,000 until Italy fully recovered the aid (European Commission 2015). As this example shows, violating international restrictions on subsidies can be very costly. Governments would generally prefer to avoid these costs, and as a result they may actively resist new international restrictions on subsidies.

Governments with the greatest electoral incentives to supply subsidies will put up the most resistance to new international restrictions on subsidies. Governments elected via plurality rules, for example, will oppose new international restrictions on subsidies to geographically concentrated groups, as illustrated by Canada's intransigence in

8 WTO Dispute DS353, www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm.

negotiations over the Trans-Pacific Partnership (TPP) agreement. In these negotiations, twelve countries worked for five years to reach an agreement that would cover nearly 40 percent of global trade. At the very last minute, subsidies to fewer than 13,000 Canadian dairy farms nearly sank the deal.[9] The disagreement arose over dairy subsidies between Canada and dairy-exporting countries, such as New Zealand, who wanted greater access to Canada's market. Canada strongly defended their supply management program, which heavily subsidizes domestic dairy farmers. The small group of Canadian dairy producers enjoyed disproportionate political influence because of their geographic concentration and Canada's electoral institutions. Dairy farmers are chiefly concentrated in the Canadian provinces of Ontario and Quebec. Almost half (49 percent) of Canada's milk farms are in Quebec, and neighboring Ontario has 32 percent of Canada's dairy producing farms (Andrew-Gee 2015, Canadian Dairy Information Centre 2015).[10] By defending dairy subsides, the Prime Minister sought to bolster his party's electoral support in Ontario and Quebec. In Canada, politicians are elected to office via plurality electoral rules in single-member districts. In such a system, where elections are won district-by-district and province-by-province, politicians have incentives to provide subsidies to producers concentrated in key areas. The Prime Minister sought to increase his party's votes by targeting aid to dairy farmers in Ontario and Quebec – even at the risk of being left out of the TPP agreement. Although Canada ultimately won concessions for the domestic dairy industry, the Canadian government also promised to compensate dairy farmers for any losses they incurred because of TPP.

Similarly, France objected to subsidy restrictions proposed as part of a new trade agreement between the EU and the United States known as the Transatlantic Trade and Investment Partnership (TTIP). French leaders threatened to kill TTIP talks before they even began, in opposition to anticipated limits on state subsidies.[11] At the heart of France's opposition were subsidies to the audiovisual services industry,

[9] According to New Zealand's trade minister, negotiations on dairy subsidies only ended around 5 a.m. on October 5, 2015. (Press conference, Monday, October 5, 2015, Atlanta, Georgia). See also, "Things to know about Canada's dairy supply management system." CTV News. *The Canadian Press*, published Sunday, October 4, 2015, www.ctvnews.ca/business/things-to-know-about-canada-s-dairy-supply-management-system-1.2594529.

[10] www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=farm-ferme&s3=nb.

[11] The Economist, Charlemagne, "L'exception française, A transatlantic free-trade deal is needlessly held up over subsidies for film-makers," June 15, 2013.

which is concentrated in the Île-de-France region (Dale 2015). The industry's geographic concentration contributes to its political clout (Frey 2014). The industry won protectionist amendments to the Franco-American trade agreement (Frey 2014) and today benefits from subsidies worth nearly €1 billion a year (Carnegy 2013). To maintain this support, France demanded that subsidies to the industry be excluded from any new restrictions on state aid agreed as part of the Transatlantic Trade and Investment Partnership (TTIP). In sum, electoral institutions and economic geography help to explain which countries resist further international restrictions on government-funded subsidies.

Demands for Reform

Governments that frequently run afoul of international restrictions on subsidies have the most to gain from reform. Given this, I speculate that the same variables that incentivize politicians to provide "illegal" subsidies will also lead them to demand reform to existing international rules. Leaders in plurality-rule countries who face geographically concentrated producers, for example, have powerful domestic incentives to demand reform to international subsidy rules. Indeed, French leaders lobbied for changes to EU rules that restrict government-funded subsidies (i.e. state aid). In 2014, the French industry minister launched a blistering attack on EU state aid rules calling them "obsolete" (Carnegy and Stothard 2014). France's industry minister argued that the EU's strict application of controls on state subsidies was preventing Europe from competing in the global market. The minister complained, "While our global industrial competitors get billions in subsidies, our bureaucracy is led by political leaders...... It is like Rome surrounded by the barbarians. We all await the fall of Rome. It's not funny" (Carnegy and Stothard 2014). The UK joined France in demanding reform to the European Union's state aid rules. These demands came in response to increased competition from China, the United States, and Japan. Some European leaders believe the EU subsidy rules hinder member-state governments' attempts to assist European companies. "This is how the European Commission is working to weaken our industry. Do you sincerely believe that this is reasonable?" Mr. Montebourg, the French industry minister wrote regarding EU state aid rules (Carnegy and Stothard 2014).

While France and the United Kingdom lobbied for changes to state aid rules, other EU member-states defend the existing restrictions. My argument helps to explain which countries push for reform to international subsidy rules and why. Governments in plurality systems like France and the United Kingdom will lobby for a relaxation of EU state aid rules to subsidize politically important, geographically concentrated groups. France, for example, focused special attention on exempting subsidies to the geographically concentrated film industry. The UK government joined France in supporting exemptions for the film industry. Like the French industry, the British film industry is geographically concentrated. The production, postproduction, and distribution sectors are clustered in London and the South East of England (BFI Statistical Yearbook 2015). The efforts of France and the UK on behalf of their respective film industries were ultimately successful. Just months after the French government threatened to veto the bloc's trade talks with the United States, the European Commission published new rules making it easier for governments to subsidize movie-making (Fox 2013). Under the new rules, governments will be allowed to cover 50 percent of the costs of a film from scriptwriting and production to distribution and promotional costs (Fox 2013). Governments will also be able to require that between 50 to 80 percent of subsidized films' budgets be spent within the country (Fox 2013). In a joint statement, UK Chancellor of the Exchequer George Osborne together with the British Film Institute said that the reforms to the EU subsidy rules were a "huge reassurance to the UK film industry," adding that the UK's film sector was responsible for 117,000 jobs (Fox 2013).

General demands for reform to EU state aid rules were also successful. In May 2014, the European Commission made it easier for member-states to assist companies using subsidies. Firms can now benefit from subsidies for a broader range of activities. Under the new rules, subsidies are allowable when the aid is clearly aimed at creating jobs or boosting competitiveness. Governments can also provide higher amounts of financial assistance without their plans being subject to prior scrutiny by the EU authorities. The reforms to EU state aid rules give member-states greater freedom to subsidize business.

As EU restrictions on state aid are relaxed, the share of governments' budgets devoted to subsidies will likely increase. Government spending on subsidies may further increase in response to pressures to assist the declining manufacturing sector. Increased government spending on subsidies has important consequences. Money spent on subsidies is money that is no longer available for other programs, such as education, health care, and social welfare. Governments facing tight budget constraints often cut spending on programs, such as social welfare, to fund industrial 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 are willing to devote larger shares of their budgets to subsidies. Political institutions alone cannot explain this choice. Instead, economic geography must be considered together with electoral institutions to fully understand governments' economic policy decisions.