

Draft! Comments welcome

**PROTECTION FOR RENT: NATIONAL SUBSIDIES AND EUROPE'S  
ECONOMY**

**Nikolaos Zahariadis**

Department of Government  
University of Alabama at Birmingham  
Birmingham AL 35294  
[nzaharia@uab.edu](mailto:nzaharia@uab.edu)

Paper prepared for presentation at the first annual meeting of the International Political Economy Society, Princeton, NJ, November 17-18, 2006.

**ABSTRACT**

Why is there still so much protectionism in light of political rhetoric extolling the virtues of free trade, favorable economic theory and evidence, and legal pressure to dismantle protectionist measures? The answer rests on four factors and their interactions: globalization, asset specificity, political power, and institutional access. I test the argument using data from 14 EU member states during the period 1992-2004. The findings clarify the variable impact of globalization on demands for protection, the impact of institutions on rent-seeking and rent-supplying behavior, and the conditions affecting domestic coalition formation. Politicians face an uncomfortable dilemma. Globalization and democracy appear to be on a collision course: the more globalization undermines democratic politics, the more democratic politics will strive to tame globalization.

## PROTECTION FOR RENT: NATIONAL SUBSIDIES AND EUROPE'S ECONOMY

*Globalization frequently imposes asymmetrical sacrifices—benefits and costs affect different element of society differently. The losers in that process will seek redress through their political system, which is national.*  
(Henry A. Kissinger)<sup>1</sup>

*[Attempts to] repel the surge of globalization...are futile and self-defeating. The paradox of protectionism is that it destroys what it seeks to protect.*  
(Alan Johnson, UK Secretary of Trade and Industry)<sup>2</sup>

In light of the gains vigorously stressed by economists and many politicians, one would expect free trade to be the prevailing international rule and impediments to trade the exception. Yet, a casual perusal of world affairs today will probably convince even the most optimistic economist that this is not the case. True, trade barriers are being dismantled, but protection remains ubiquitous. As Irwin (2005, 27) puts it regarding market integration and trade, “if we focus not on how far global integration has progressed in the past few decades but on how far it has to go to achieve full integration, we’re impressed by how *little* integration there is” (emphasis in the original). If gains from trade are so large and self-evident, why is protectionism easy and free trade difficult to pursue? Put differently, why do governments offer the levels of subsidies that they do?

I build an asset influence model of trade policy which highlights the motives and ability of social actors to demand and get protection from government. While there is no universally accepted definition, subsidies generally refer to government support to production, which aims to reduce the cost of input factors and consequently to increase the quantity of output produced. I do not deal with consumption (e.g., welfare) subsidies. I offer a political explanation which puts forth the argument that under threat of international competition disbursement of producer subsidies varies systematically with the degree of asset specificity in particular institutional contexts. The European Union (EU) provides the most fertile ground to test this argument because most subsidies are illegal under EU legislation, but they are still ubiquitous. The findings, therefore, acquire considerably more weight if it can be shown that domestic political considerations affect the disbursement of protection in the face of strong external political, economic, and legal pressure to the contrary. Far from being impotent, democratic states continue to shield social actors from the vagaries of the global market, albeit with less intensity than before.

### **The Asset Influence Model of Subsidy Protection**

Why do governments subsidize their industries? The answer lies in the cost that owners of economic assets face in moving assets across industries, gains and losses from globalization, and the political and institutional incentives that governments have in disbursing subsidies.

The point of departure is Grossman and Helpman's (1994; G-H) political contribution model. Looking at the domestic policy process, the authors theorize that groups vie for protection from adverse external economic conditions by making political campaign contributions. Although G-H examine protection at the sectoral level within a single national economy, I analyze the implications of the model at the national level across several national economies.

Protection is conceptualized as a common agency problem where many principals, i.e., industry groups, lobby a common agent, i.e., government, for support (Dixit, Grossman, and Helpman 1997). Groups lobby politicians to maximize benefits to their members by providing campaign contributions. Policy makers choose to curry favors, i.e., grant trade protection, based on an objective function that takes into account both their own chances for re-election and the voters' welfare. The model's political equilibrium is examined as a two-stage simultaneous non-cooperative game where lobbies choose their contribution schedules in the first, and the government sets the policy in the second.

The authors hypothesize that protection is a function of demands by powerful groups most affected by trade, their ability to pass the cost onto the rest of society, and the organizational characteristics of lobbying. At an equilibrium level with truthful contribution schedules—i.e., the shape of the schedule reveals the lobby's true preferences at equilibrium point—the choice depends not on the level of actual contributions but on other factors. Because groups don't compete against one another for protection but against the politician's estimate of consumer welfare, i.e., the social cost, the political power of contributing groups and their level of organization are crucial parameters. Moreover, the actual ability of policy makers to supply protection depends on their capacity to pass the cost of protection on to the rest of society.

I modify these ideas by relaxing several assumptions. First, G-H assume constant world prices; I assume variable ones. Second, G-H assume a specific-factors framework, i.e., moving assets across industries is costly; I assume cost varies across industries. Third, G-H assume an undifferentiated, pluralist national institutional framework, where groups compete for influence; I assume it's organizational capacity rather than organizational level that makes the difference.

My model begins by viewing subsidies as an insurance element in the sense that government compensates actors in specific circumstances against adversity. I conceptualize a model of political economy in a democracy that operates on two levels. Each is nested within the other and both have a significant impact on policy outputs (Hall 1999, 148-150). First order relationships analyze actor behavior. For example, globalization affects returns on assets and actor preferences regarding protection. Second order relationships deal with institutionalized interactions that affect the stability of first order relationships. For example, pressure for protection goes through specific institutional channels that mediate, refract, and shape access to policy makers. The willingness of policy makers to act partly depends on the intensity of actor demands and

the specific ways that demands are filtered through institutions. The following three propositions describe the core of the model.

1. *The domestic policy process crucially affects the dynamics of protection.* Social actors form lobby groups and confront incumbent policy makers with contributions that affect the latter's chances for reelection. They seek subsidy protection against the adverse effects created by increasing exposure to global economic forces. The willingness of politicians to listen to affected groups critically depends upon the political power that groups wield. Governments never have enough resources to address all the issues before them. They have to choose what issues to attend and what resources to expend addressing the concerns of constituents (Zahariadis 2003). In this context, more powerful groups will obviously be more likely to be successful at getting what they want than others. The ability to be heard increases with political power.

*H1: More powerful groups are more likely to get higher levels of subsidies.*

Incentives to supply rewards are carefully circumscribed by the political institutional system within which groups and governments operate. Organization is important but national institutions regulate not only the level of organization but more importantly the organizational capacity of groups to access policy makers and make their voices heard (Zahariadis 2005). In this way, a simple group-organizational variable does not adequately capture the ability to demand or the willingness of policy makers to supply subsidies.

Institutions regulate access and shape rent-seeking and rent-supplying behavior. Actor "behavior is deeply conditioned by [the] institutional environment" within which actors are embedded (Hall 1999, 148). Once institutionalized relationships are taken into account, it becomes easier to see how the translation of actor preferences into political demands is partly shaped by national political institutions. While there is regional variation, national institutions are important because a national institutional framework frames actor incentives and constrains microeconomic behavior (Soskice 1999). Following (Garrett and Lange 1996), I examine two types of institutions: socioeconomic institutions and formal political institutions.

Corporatism is the main socioeconomic institution. It operates outside the formal public political sphere. The encompassing coalitions implied by corporatist arrangements lead to compensatory deals. Groups negotiate and finalize agreements on more subsidies on a continuous basis in exchange for industrial peace and policy stability. The high level of organization and the structured access to power necessitated by corporatism render policy makers more susceptible to rent-seeking subsidies than similar demands placed within the context of pluralist systems (Zahariadis 2002).

Increased exposure to world markets enhances external risk. Governments mitigate this risk by providing compensation insurance in the form of welfare spending, protectionism, and the like. Cameron (1978) describes one mechanism that links openness and institutional configurations to public spending. He maintains that more

open economies have higher levels of industrial concentration and consequently higher unionization and stronger labor organizations. Both factors facilitate the formation of strong peak associations and centralized bargaining. Katzenstein (1985) extends this argument to a wider array of incentives in small and more open economies. He includes historical factors and economies of scale. Rodrik (1998) extends the argument to a broader sample of developed and developing countries. In corporatist arrangements, highly organized actors are able to demand greater compensation insurance to mitigate the risk of volatility from world markets. In return they promise wage moderation, flexible adaptation to production processes, and policy stability and industrial peace. The end result of these extra-parliamentary negotiations is more government transfers in the form of unemployment insurance, job training, aid for failing industries, and the like.

*H2: In more corporatist (more pluralist) political systems, successful demands for more subsidies are likely to be stronger (weaker).*

Formal political institutions also make a difference. I examine the effects of two institutions: the number of veto points the degree of majoritarianism in a country's electoral system.

Birchfield and Crepaz (1998) adapt Lijphart's (1999) institutional argument to describe veto points. They divide them in two types: collective and competitive veto points. They are two qualitatively different forms of diffusing political power, which have redistributive implications. *Collective veto points* refer to consensual institutional incentives that enable access to a broad array of actors and "force" political bargains to be made in the face of conflict and adversity. The best way to conceptualize this dimension is through a continuum of shared responsibility and collective agency on the one hand and divided agency and responsibility on the other (Goodin 1996). Collective veto points disperse political power within institutions. Under these conditions, policies tend to be more responsive to different interest groups because of "logrolling." As the number of collective veto points goes up, subsidy protection rises. Institutions, such as multiparty coalition governments, tend to force bargaining and logrolling among participants. Because the assent of many parties is needed in order to form a government or pass legislation, compromises will include satisfying a higher number of claimants than would otherwise be the case. Groups adversely affected by trade push for these types of bargains on a continuous basis, driving up government expenditures (Crepaz and Moser 2004). In countries with such "enabling" institutions, protection is more likely to be the outcome as opposed to countries with single majority party government.

*Competitive veto points* refer to a situation where political power is diffused among different and separate institutions. In this case, actors hold mutual veto powers, leading occasionally to deadlock and immobilism. Competitive veto points are what most analysts understand veto points to be. While policy change may be more difficult in cases of higher number of competitive veto points (Tsebelis 2002; Crepaz and Moser 2004; O'Reilly 2005), protection may also come in higher levels. For example, the presence of a bicameral legislature means that more access points are available to ask for subsidies. If the US House of Representatives votes down the request, there is always the Senate. In

light of the fact that powers are effectively equal, that is, each chamber holds veto power, the chances of getting subsidized increase. The literature is replete with such institutional venue-shopping in search of the chamber with the most likely favorable response to societal demands (e.g., Jones and Baumgartner 2005).

*H3: As the number of collective and competitive veto points increases, the likelihood of subsidies also increases.*

There are two fundamental ways to structure any electoral system, with several variations within each: proportional representation (PR) with multimember districts, where votes translate directly and proportionately into seats; and majoritarian systems with single member districts, where a plurality or majority of votes wins the sole available seat. Although the findings are not uniformly conclusive (Milner and Judkins 2004), most analysts agree with Rogowski (1987, 209) that PR affects the power that producer groups have in influencing policy; in this case subsidies are reduced. “Pressure groups are restrained where campaign resources or the legal control of nominations are centralized in the hands of party leaders.” For example, in cases where the electoral system tends to reward more votes with more seats, e.g., a PR system, large coalitions are needed to supply subsidies. Assuming there are differences in preferences across groups, several groups need to coalesce in many districts to capture the majority of votes needed to pass a subsidization bill. This is very difficult to achieve. National representatives who do not have narrow, geographically-based constituents have fewer incentives to offer protection (McGillivray 2004). In contrast, in systems where winner takes all, e.g., majoritarian systems, the coalitions need to be large enough to capture single districts. The opposition in the latter case loses out completely because only one member can be elected. In essence, because producer groups have less power in PR systems, governments are less likely to supply subsidies.

*H4: As electoral disproportionality grows, i.e., as systems become more majoritarian, the overall amount of subsidies will increase.*

2. *The ability (or cost) of asset owners to move their assets to more profitable uses motivates domestic groups to demand subsidies.* Actor preferences are shaped endogenously by the ability of owners of factors of production to put assets to alternative uses (Frieden and Rogowski 1996). The greater the returns on assets in a given activity, the more likely actors are to favor continuing the activity. Specific assets tend to have high rates of return; otherwise, their owners would redeploy them in a different activity. The greater the ability to move assets, the lower the incentive will be to ask for more subsidies. Losses do not loom as large because actors have options for a more profitable allocation of assets. Conversely, actors who face significant domestic barriers to entry in and exit out of profitable activities will experience heavier losses. Facing fewer options for exit, they will seek more voice (Hirschman 1970). Consequently, incentives to demand more subsidies are determined partly by the degree of asset specificity. Alt *et al.* (1999), Hiscox (2002), and Zahariadis (2001) provide evidence from OECD countries supporting this proposition.

There are two aspects of specificity: labor and capital specificity. Both have implications for protection. Higher levels of specificity among workers have consistently positive effects on subsidy disbursement. Capital specificity also has a positive impact on subsidy disbursement. The rallying cry is true: subsidies are mostly about “jobs, jobs, jobs.” What happens as the cost of moving assets to more profitable activities decreases? The stakes become lower because asset owners may move assets rather than lobby government. Their profits will not be squeezed as much and their voices for protection will not be as strong. In the case of perfect mobility, the stakes for protection among, say, owners of capital are zero, assuming a developed, capital-abundant economy.

*H5: In countries where industries have more specific assets, national governments disburse higher levels of subsidies.*

3. *Increasing exposure to global economic forces affects subsidization efforts.* To understand what motivates actors to act, analysis must specify the type and level of exposure to global markets (Frieden and Rogowski 1996). If all else is equal, world prices and domestic prices should be equal. Prices are signals by which information is transmitted. The greater the difference between prices, the stronger the pressure to exit in search of higher returns. An exogenous easing of international exchange has predictable effects on domestic factor returns. Easing may take place either because of advances in technology, fluctuations in transportation costs, financial crises, and the like. As easing intensifies, domestic producers feel the effects differently. The greater the difference between world and domestic prices, the higher the cost of protection, and consequently the greater the differences in factor returns. The groups, who witness domestic lower prices because different sectors experience different exposures at any one time, will prefer protection. Domestic prices have to increase or groups will exit. They are the losers. Those groups who experience gains from exposure, i.e., high domestic prices, will prefer greater liberalization. They are the winners. Hence subsidy protection varies predictably by exposure to globalization.

Of course not all globalization is created equal. The dimensions of globalization have contradictory effects. While trade and foreign direct investment positively affect the propensity of policy makers to disburse more subsidies, portfolio investment has the inverse impact. The difference is attributed to barriers to entry and exit. In both cases, the losses are immediate and the possibility of redress political in the sense that high barriers to exit exist. However, because short-term investment, such as portfolio investment, involves fewer sunk costs and can move more easily in and out of national borders, it has a negative effect on protection. In this case, governments in more heavily exposed economies disburse on average fewer subsidies.

*H6: Higher levels of trade openness are likely to lead to more subsidies.*

*H7: Higher levels of FDI openness are likely to lead to more subsidies.*

*H8: Higher levels of portfolio openness are likely to lead to fewer subsidies.*

However, the answer to the subsidization puzzle is not that simple. The effects of globalization are both independent and conditional. Their direction and strength vary considerably on the basis of asset specificity and institutional configurations. For example, while groups adversely affected by trade appear on average to be less successful in more pluralist institutional environments, their ability to extract additional rents increases sharply with the level of exposure to international trade. At higher levels of exposure, losses generally loom large. Because the system favors adjustment assistance on an episodic, non-continuous basis, the level of protection is likely to be high. In contrast, because compensatory deals tend to be on a continuous basis to take the edge off the extreme social dislocations produced by wild market fluctuations, the level of subsidies is more likely to be on the one hand, higher than in pluralist systems at low levels of trade but on the other hand, lower at higher levels of trade. In short, incentives to act change as a response to economic losses from globalization change because institutions refract the extent of losses and the ability to act.

The argument reinforces the point made by Odell (1990) and others that our understanding of trade policy is not aided by sweeping generalizations about the impact of variables but by exploring the effects of explanatory factors under different conditions. Only then may we begin to acquire a more complete and properly specified picture of the dynamics of protection across different national contexts.

### **Data and Measurement Issues**

I test the argument using data from 14 EU member states during the period 1992-2004.<sup>3</sup> The dependent variable is state subsidies, which refer to a form of state intervention used to promote certain economic activities. Data are taken from the European Commission's (2006) *Scoreboard* and are expressed as annual percent of total aid over GDP. The Competition Directorate-General provides annual figures of national subsidies (or state aids as it calls them) disbursed by every EU member state. The dataset (14 years by 13 countries) offers the most complete and detailed picture of national subsidies by any international organization with figures that are cross-nationally and temporally comparable.

The independent variables include the following. Two aspects of *globalization* are important: trade and capital. *Trade* openness is measured as annual percent of exports plus imports of goods over GDP. *Capital* openness is measured in two ways. The first indicator includes *FDI* (or long-term) investment. The second indicator includes *portfolio* (or short-term) investment. Both figures are expressed in millions of U.S. dollars, converted into percentages of GDP. Higher levels of the indicators signify higher levels of openness. Data on trade and GDP are taken from OECD (2006a). FDI figures are from OECD (2005b) and portfolio investment from IMF (various years).

*Asset specificity* is measured by two indicators. Following Hiscox (2002), I calculate labor specificity as the coefficient of variation (standard deviation over mean in percentages) in wages across industries, and capital specificity as the coefficient of variation in profits across industries.<sup>4</sup> Higher numbers indicate greater specificity. Data

are taken from the OECD's databases on *National Accounts* (various years), *Labour Force Statistics* (various years), and the structural analysis (STAN) database (2004).

The impact of *institutions* is captured by reference to three elements: pluralism, veto points, and electoral system. Lijphart (1999) supplies a summary index number which measures degree of corporatism. In his index, lower numbers indicate more corporatist arrangements. For ease of interpretation, therefore, I label this indicator pluralism, and expect a negative sign. Lower levels of pluralism, i.e., higher corporatism, should lead to more subsidies. Veto points are captured by the use of two indicators. Competitive veto points, which correspond to what Lijphart terms the "federal-unitary" dimension, are expressed as an index number, the higher end of which denotes more veto points. Collective veto points, which correspond to the "executives-parties" dimension, are also expressed as an index number, the higher end of which denotes greater tendency toward shared responsibility and consensus democracy. The disproportionality of the electoral system takes into account the squared differences between the percentage of seats and the percentage of votes parties receive in national legislative and presidential elections. Higher numbers indicate greater degree of majoritarianism. All institutional data are taken from Lijphart (1999).

A group's *political power* measures the ability of groups to extract subsidies from the government. Following Grossman and Helpman (1994) it is expressed as the inverse of import demand. Figures for import demand are percentages of the total domestic market taken up by imports. They are found in the OECD's database of *Trade Statistics* (2006b).

I use pooled time series analysis to analyze the data. A look at the levels of tolerance and variance inflation factors suggests that the level of collinearity among the independent variables is below what is considered to be problematic in the literature (Fox 1991; Chatterjee, Hadi, and Price 2000).<sup>5</sup> The estimates should, therefore, be unbiased and consistent. Unfortunately, examination of the Durbin-Watson statistic reveals the presence of strong serial correlation within units. For this reason, I transform the data *via* the Prais-Winsten technique, which includes an AR(1) estimation that retains the first observation.

Panel data of this kind also frequently suffer from heteroscedasticity and contemporaneous correlation of errors.<sup>6</sup> To take these problems into account, analysts generally opt to calculate either robust standard errors or panel-corrected standard errors. Panel-corrected standard errors are recommended in cases where the temporal intervals are greater than the number of units (Beck and Katz 1995). In my case, the number of countries is slightly higher than the number of years. For this reason, I follow the recommendation by Beck *et al.* (1993) and calculate robust standard errors.<sup>7</sup>

To capture the budgetary logic of the puzzle of subsidies, I lag the main independent variables by one year so that, say, asset specificity at time  $t-1$  is used to explain the disbursement of state subsidies at time  $t$ . The exceptions are the institutional variables, which are time invariant. The interactive terms are the products of the

independent variables at the time of measurement, i.e., all of them contain time lags except for institutions.

The basic structure of the model's equation is the following:<sup>8</sup>

$$\begin{aligned} \text{SUBSIDY}_{i,t} = & a + b1\text{ASSET}_{i,t-1} + b2\text{GLOBALIZATION}_{i,t-1} + b3\text{INSTITUTION}_{i,t} \\ & + b4\text{POLITICAL POWER}_{i,t-1} + b5\text{GLOBALIZATION}*\text{ASSET} + \\ & b6\text{GLOBALIZATION}*\text{INSTITUTION} + u \end{aligned}$$

where  $a$  is the constant term,  $i$  is country and  $t$  is year. SUBSIDY refers to amount of subsidies. ASSET refers to asset specificity, measured as coefficient of variation in wage costs and profits. GLOBALIZATION contains three indicators: trade openness, measured percent trade in goods over GDP; FDI openness is percent total FDI (incoming and outgoing) over GDP; and portfolio openness is percent portfolio investment over GDP. INSTITUTION refers to national institutions and includes four indicators measured as index numbers: pluralism, competitive veto points, consensus veto points, and electoral system. POLITICAL POWER refers to the affected group's power to get subsidies and is measured as the inverse of import demand;  $u$  is the disturbance term. The descriptive statistics of all variables are included in the appendix.

### **Analyzing the Disbursement of National Subsidies: A First Cut**

I regress state subsidies on four main independent variables and their interactions: globalization, asset specificity, political power, and national institutions. Looking at the equations in Table 1, the model has moderate overall fit. It explains overall about one-third of the variance in subsidies as a percent of GDP when taking into account the explanatory factors.

Table 1 here

There are several striking features about the table. Keeping in mind the general decrease in subsidies over time, it is not surprising that the constant for the estimation is negative. This means there is a general tendency toward fewer subsidies over time, but several factors arrest or accelerate the decline. The point is not that subsidies are multiplying; but rather in light of institutional and political commitment to free trade, why is there still so much protection?

Globalization has an important effect on subsidies. Bhagwati (1998) argues forcefully that analysis must differentiate between globalization in trade and capital. Frieden (1991) extends this argument by showing that increasing exposure to capital investment from abroad alters the dynamics of domestic coalition formation. I show that not all globalization is created equal. Trade openness has a significant positive effect when accounting for disproportionality and veto points (equations 2 and 3). Portfolio investment has a significant negative effect in the presence of pluralism (equation 1). Consistent with the hypotheses of the model, higher levels of openness lead to more subsidies. When exposure to global trade increases by 1 percent, protection increases by

0.49 percent (equation 3). Groups adversely affected by trade, organize and successfully lobby for more subsidies to ease the pain.

Portfolio investment has the hypothesized negative effect on subsidies. The threat of short-term capital flight is a powerful motivator against subsidy protection. One percent increase in portfolio investment leads to .005 percent decrease in subsidies. Although the effect appears to be small, as capital controls continue to fall and as the amount of portfolio investment increases, the magnitude of the impact is expected to grow over time (Drucker 1997).

Labor specificity has a consistently positive effect on subsidies. As the coefficient of variation goes up by 1 percentage point, that is, moving labor assets across industries becomes costlier for various reasons, the amount of subsidies as a percent of annual economic output increases by .018 percent (equation 2). Considering that the subsidy mean for all 14 countries in the sample for the period 1992-2004 was .86 percent of GDP, labor specificity matters. Worker inability to move across industries effortlessly gives rise to demands for protection. Unions contribute to politicians' campaigns and they in turn reward these contributions with subsidy protection. Interestingly, capital specificity, i.e., the ability of owners of capital to move assets across industries does not have a statistically significant independent impact on the allocation of subsidies. It is possible that intra-national movements of capital have indeed become less costly and the need for subsidies in favor of protecting profits is subdued.

The findings contradict somewhat those of Hiscox (2002). Looking at the relationship between specificity and votes in the US, the author finds that labor specificity has an overall positive impact and capital specificity has a negative effect on protection. However, a cross-national examination of a more direct relationship between specificity and protection fails to ascertain the impact of capital specificity. True, workers in the industrialized world make a difference. They demand and get protection when they feel threatened. However, capital owners do not appear equally capable or willing. It is not that they are opposed to protection, as Hiscox suggests. They are simply indifferent or at least eager to let workers do the talking.

Political considerations also have a strong impact. Consistent with Grossman and Helpman's (1994) prediction, increases in group political power have a strong positive effect on the disbursement of subsidies. The result is not surprising, but it bears repeating. In countries where imports have made significant inroads, protection is generally lower because the affected groups have grown politically weaker. The implication is that foreign competition eliminates over time domestic producers who will no longer lobby for protection. As a result, the overall trend of subsidies will decline. The data clearly bear out this prediction. Free trade begets free trade!

The model predicts that the level of organization, both in socioeconomic and formal political terms, has a considerable influence on the ability to secure government subsidies. Confirming in part the model's prediction, as the degree of pluralism increases,

the amount of subsidies goes down. In highly organized national systems, such as those with corporatist arrangements, the level of subsidies is on average higher.

There are two reasons for this finding. First, pluralist systems are more susceptible to short-term demands for protection. Given the annual negotiations between workers and employers and the explicit need for stability and industrial peace, corporatist systems take a longer-term view of compensation from adverse effects from globalization. Long-term compensation measures are funded at higher rates, including welfare payments, unemployment insurance, and the like. Gains (losses) in pluralist systems loom large even in the short-term, so there are likely to be higher fluctuations. The second reason is that in a highly organized system, disparities in organizational capacity will be minimal. Consequently, the marginal benefits of lobbying for protection are likely to be minimal. In light of compensation schemes designed to minimize losses the actual amounts of subsidies are likely to be higher.

The other institutional variables have variable effects. The disproportionality of the electoral system has the expected sign, but it is not statistically significant. The study, therefore, cannot validate or reject the literature's claims; disproportionality is unrelated to protection either independently or conditional to other factors. What's interesting is the effect of veto points on subsidy disbursements. Subsidies go up as the number of competitive veto points increases. Because they face a higher number of decisive no votes, groups have to bribe more policy makers to secure protection. As a result, the amount of subsidies increases. In addition, collective veto points also have a strong positive effect. As countries move closer to consensus democracy, i.e., they become more inclusionary, their redistributive capacity increases. Institutions force more bargaining solutions, which lead to greater use of "logrolling," ultimately expanding the ability of the state to protect disaffected groups.

This argument some but not all the claims made by Crepaz and Moser (2004), who have explored the impact of institutions on protection and welfare. First, collective institutions do indeed lead to greater redistribution in the form of subsidy protection. Such institutions explain far more than inflation as Lijphart (1999) originally reported. However, the findings here stand in sharp contrast to Crepaz and Moser (2004) who find that competitive veto points reduce redistribution and public expenditures. It may be that such institutions are in fact more susceptible to protectionist demands primarily because disaffected groups can block legislation and therefore call attention to their plight. Because the assent of many veto players is needed to pass legislation, smaller groups in fact enjoy disproportionate power.

Somewhat similar and more directly relevant arguments are made by O'Reilly (2005) and Henisz and Mansfield (2006). O'Reilly finds that as the number of veto points goes up, the change in tariff levels is reduced dramatically by 10 percent, implying that higher levels of institutional veto points are associated with smaller absolute changes in protection. Such systems are impervious to short-term demands by small disaffected groups. Applying the insight to my equations, the expectation is to find lower rates of subsidization as the number of institutional veto points increases. Quite the contrary, I

find that the rate of protection actually increases in such systems (within the context of an overall decline in subsidies as discussed above). Henisz and Mansfield (2006) also test the impact of veto points on trade openness. They find that in stable democracies, i.e., the industrialized world, trade openness declines, and consequently protection increases, as the number of veto points increases. Using an indicator of veto points that corresponds somewhat to the indicator used here to measure competitive veto points, they find, with subsequent qualifications, that “changes in import penetration [their measure of commercial openness] are more likely to occur as the number of number of veto points declines” (209). My study confirms their claim. Protection is more likely when veto points increase. Divided government, in other words, impedes rather than promotes free trade (Lohmann and O’Halloran 1994).

### **Looking at Interactive Effects**

Globalization has a differential impact on subsidies depending on particular configurations in the domestic policy process. Societal demands and institutions have a conditional impact on protection (Henisz and Mansfield 2006). As Table 1 shows, many of the conditional relationships hold true. Interestingly, the conditional hypotheses regarding trade and labor specificity are consistently in the same direction across the three equations and statistically significant, raising the confidence in the robustness of the relationship. Of the interactive variables regarding institutions, the degree of pluralism makes a big difference both independently and when it interacts with trade. The same holds in the case of collective veto points.

Figure 1 here

To get a better sense of the interactive relationships, I calculate the counterfactual simulation for one multiplicative term in equation 1 that is statistically significant at the .05 level or better. The purpose of calculating counterfactuals for only one relationship, out of a potential universe of ten, is purely illustrative. I want to show the effects of some variables conditional on the presence of specific levels of other variables to illustrate the point that globalization has important direct effects, but it also interacts with the domestic policy process to produce notable outcomes. The relationships reveal interesting patterns over and beyond the independent effects of each of the variables.

The data in Figure 1 are calculated on the basis of Table 1. All variables are set at their means, while trade and pluralism and trade and labor specificity are allowed to vary respectively. I do not report the tail ends of the distributions in the sample; rather I rely on the 20<sup>th</sup> and 80<sup>th</sup> percentile figures in each variable. In this way, readers may gain better insight in what happens to particular relationships when variables acquire different values. For example, the 20<sup>th</sup> percentile in the pluralist index corresponds to Denmark, a relatively corporatist but not the most corporatist country in the sample, while the 80<sup>th</sup> percentile represents Spain, a country with a more pluralist organization of interest groups. In similar fashion, the 80<sup>th</sup> percentile in trade corresponds to Holland in 1995, while the 20<sup>th</sup> percentile is Italy in 1998.

The numbers inside the matrix cells represent state subsidy disbursements as percent of GDP. Moving from left to right tells whether more pluralism or higher labor specificity increased subsidies. Moving up or down shows what happens to subsidies when trade exposure decreases or increases. Looking at the top box at the right corner, we see that the least amount of subsidies is disbursed in more pluralist countries at low levels of trade exposure. The simulated figure is negative, implying that in pluralist countries governments do not protect their industries. Also more corporatist states give out more subsidies, validating the point that the likelihood of protection increases when the level of group organization goes up. At lower levels of trade of the interactive term this is true.

The amount of subsidies is supposed to be higher when the stakes are high, i.e., at high exposure to trade. This is also borne by the data. But in contrast to expectations, the effects of pluralism reverse as trade exposure increases. At high levels of trade exposure, pluralism now has a significantly positive effect on subsidies. The amount of subsidies increases dramatically and surpasses that of more corporatist countries. The implication is that institutions have a significant effect, but the relationship, whether positive or negative, really depends on the level of trade exposure. In more pluralist systems, affected groups have disproportionately more power to get what they want in the short-term. Political contributions make a big difference, as the model suggests, but only when the stakes are high, the losses are heavy, and policy makers are more accessible to a variety of groups. Protectionism is the outcome of a contingent relationship (Boix 2004). Its effects truly depend on the level of exposure to world markets. Consequently, the compensation hypothesis posited by several analysts receives only partial support. There is a strong positive independent effect (more corporatist countries provide more subsidies), but a strong negative conditional effect (more corporatist countries provide fewer subsidies when trade exposure is high). In light of the fact that more corporatist countries are also more exposed to world markets, the interactive term acquires greater theoretical significance. Whether or not policy makers adopt protectionism depends on independent and perhaps more importantly conditional relationships.

## **Conclusion**

Why is there still so much protectionism in light of political rhetoric extolling the virtues of free trade, favorable economic theory and evidence, and legal pressure to dismantle protectionist measures? The answer rests on four factors: globalization, asset specificity, political power, and institutional access. Naturally, not all groups have equal access to politicians, and not all politicians are equally inclined to grant protection. A group's political power shapes policy makers' incentive to listen to protectionist demands, while national formal public institutions canalize the demands and shape the willingness or ability of elected officials to respond.

Global markets affect the distribution of wealth in domestic economies as well as the ability and options of affected groups to take political action. Inevitably, domestic groups will form coalitions to demand policies that shield them from adverse economic consequences. Such redistributive activity is politically contentious and economically

inefficient. To understand why, analysis must concentrate on the political and economic incentives of interest groups and the institutional context within which policy is made. Redistribution is a political game that is dependent on rent-seeking and rent-supplying capacity.

Consistent with Grossman and Helpman's (1994) prediction, rent-seeking matters; increases in group political power have a strong positive effect on the disbursement of subsidies. Access to policy makers as well as gains and losses are also canalized and mediated by institutional configurations. The findings support and expand the notion advanced in G-H that organization matters; rent-supplying is essential. For example, consider the principle of compensation. Side-payments in the form of adjustment assistance are expected in the more organized corporatist system. The results support this contention on average. Conversely, more pluralist arrangements tend to lead to fewer subsidies. This is a consistently strong result applicable to the majority of cases examined. But the findings are not as clear-cut. While pluralism restricts the use of subsidies, the final policy recommendation is not the destruction of corporatism. As the conditional relationship regarding total subsidies in Figure 1 showed, the effects of pluralism reverse at higher levels of trade openness. More pluralist countries give out more subsidies at high levels of trade. If one is to take into consideration the fact that countries may become more open over time, the message is that corporatism rather than pluralism is the preferred institution of choice in the long-term.

Since the publication of Rogowski's (1989) book on trade and coalitions, a lively academic debate has ensued regarding the ability of groups to form protectionist coalitions and the conditions under which this is feasible. The argument here qualifies the enabling conditions by finding that trade and capital have significant but often contradictory effects on coalition formation. Protectionism is not simply the result of trade effects.

Exposure to the global economic environment affects the formation of coalitions. Globalization, as the literature predicts, creates winners and losers who seek to be compensated by the state. But not all globalization is created equal. Coalitions are not formed simply in response to increasing trade as Rogowski and much of the coalition formation literature conceptualizes (e.g., McGillivray 2004; Hiscox 2002). Trade is important, but increasing exposure to capital movements qualifies the dynamics of coalition formation in domestic economies.

Counter to Bhagwati's (1988) claim, increasing exposure to global market forces largely increases rather than decreases the likelihood of protection. Trade has a positive impact. Losers coalesce and contribute to policy makers' political campaigns. Their coalitions overcome the trade off between contributions and consumer welfare, and ultimately get subsidized. The same goes for long-term investment, although only conditional to increases in capital specificity. The presence of foreign manufacturers in developed democratic economies increases the likelihood of subsidization. Contrary to expectations, FDI does not appear to buy good will. But not all is doom and gloom. What analysts have failed to show, and what emerges from this study, is that short-term

investment matters in some cases (equation 1). As exposure to portfolio investment increases, the pressures for protection decrease. Globalization does not lead to more or less protectionism. The answer is more complicated than that. And there is more. If one accepts Drucker's (1997) assertion that capital movements in the future will matter more than trade, claims about globalization must be further qualified. Whereas globalization supplied incentives that generally encouraged the formation of protectionist coalitions in the past, it may not do so in the future.

Contrary to conventional wisdom, the politicians are not powerless; but they face an uncomfortable dilemma. Greater exposure to global economic forces produces significant benefits, but it also carries significant costs. Full global market integration and democratic governance are engaged in a zero-sum confrontation (Rodrik 2005). The more policy makers push for one, the more they undermine the other.

Governments need to balance the benefits from exposure to global economic forces with the costs of maintaining an open economy. This is not an easy task. Increases in exposure to trade and long-term capital create social dislocations and costs that government compensates by raising production subsidies. Greater pressure for protectionism places strains on democratic institutions to deliver outstanding performance in the face of a rapidly changing and challenging external economic environment. However, increased fiscal profligacy in the face of severe pressure toward greater efficiency emanating from globalization is not really an option. The new institutions that have been created as a response aim to insulate economic policymaking bodies from democratic politics to reduce the likelihood of economic inefficiency because of political interference (Rodrik 2005, 205). This is precisely the motive behind attempts in the past decade or so to create strong independent central banks in Europe and elsewhere. In this sense, globalization undermines democratic accountability.

However, the relationship goes the other way as well. The present study demonstrates that governments cannot resist adjustment assistance in the form of subsidies to producer groups. Under certain conditions groups successfully get the protection they want. Politics tames the market, producing economic inefficiency. In this sense, democratic discourse undermines global economic markets. More globalization leads to higher social costs, which in turn create the requisite conditions for more protection. The problem becomes that the more globalization undermines democratic politics, the more democratic politics will strive to tame globalization in much the same way that Polanyi (1957) predicted half a century ago.

To the extent that protectionist demands go unheeded, government grows unresponsive, increasing the chances of political turmoil, social unrest, and policy instability. What good is a democratic state if it cannot provide for its citizens' welfare, however contentious and inefficient such redistribution may be? The stronger the government's response, however, the more production is skewed toward economic inefficiency and away from the supposed benefits of globalization. What good is globalization if it does not deliver all the economic benefits while it retains all the social costs?

More democracy is desirable. Citizens naturally expect government to respond to their needs as much as possible. More globalization is also desirable because it creates wealth and generally lowers economic costs. Unfortunately, having our pie and eating it too does not appear to be an option. One risks undermining the other. Contrary to political rhetoric and academic expectations, full market integration and a strong democracy may indeed prove to be incompatible.

## References

- Acemoglu, D., and J. A. Robinson. (2001) Inefficient Redistribution. *American Political Science Review* **95**: 649-661.
- Alt, J., and M. J. Gilligan. (1994) The Political Economy of Trading States: Factor Specificity, Collective Action Problems, and Political Institutions. *Journal of Political Philosophy* **2**:165-192.
- Alt, J., F. Carlsen, P. Heum, and K. Johansen. (1999) Asset Specificity and the Political Behavior of Firms: Lobbying for Subsidies in Norway. *International Organization* **53**: 99-116.
- Beck, N., and J. Katz. (1995) What to Do (and not to Do) with Time-Series-Cross-Section Data in Comparative Politics. *American Political Science Review* **89**: 634-647.
- Beck, N., J. Katz, R. M. Alvarez, G. Garrett, and P. Lange. (1993) Government Partisanship, Labor Organization, and Macroeconomic Performance: A Corrigendum. *American Political Science Review* **87**: 945-948.
- Bhagwati, J. (1998) The Capital Myth: The Difference between Trade in Widgets and Dollars. *Foreign Affairs* **77** (3): 7-12.
- Bhagwati, J. (1988) *Protectionism*. Cambridge, MA: The MIT Press.
- Birchfield, V., and M. Crepaz. (1998) The Impact of Constitutional Structures and Collective and Competitive Veto Points on Income Inequality in Industrialized Democracies. *European Journal of Political Research* **34**: 175-200.
- Boix, C. (2004) *Between Redistribution and Trade: The Political Economy of Protectionism and Domestic Compensation*. University of Chicago, mimeo.
- Cameron, D. (1978) The Expansion of the Public Economy: A Comparative Analysis. *American Political Science Review* **72**: 1243-1261.
- Chatterjee, S., A. Hadi, and B. Price. (2000) *Regression Analysis by Example* (3rd Ed.). New York: Wiley.
- Crepaz, M. (2001). Veto Players, Globalization and the Redistributive Capacity of the State: A Panel Study of 15 OECD Countries. *Journal of Public Policy* **21**: 1-22.
- Crepaz, M., and A. W. Moser. (2004) The Impact of Collective and Competitive Veto Points on Public Expenditures in the Global Age. *Comparative Political Studies* **37**: 259-285.
- Dixit, A., G. M. Grossman, and E. Helpman. (1997) Common Agency and Coordination: General Theory and Application to Government Policy Making. *Journal of Political Economy* **105**: 752-769.
- Drucker, P. F. (1997) The Global Economy and the Nation-State. *Foreign Affairs* **76** (5): 159-171.
- European Commission. (2006) Competition Directorate, *State Aid Scoreboard*. [http://europa.eu.int/comm/competition/state\\_aid/scoreboard/](http://europa.eu.int/comm/competition/state_aid/scoreboard/) last accessed January 28, 2006.
- Frieden, J. A. (1991) Invested Interests: The Politics of National Economic Policies in a World of Global Finance. *International Organization* **45**: 425-451.
- Frieden, J. A., and R. Rogowski. (1996) The Impact of the International Economy on

- National Policies: An Analytical Overview. In *Internationalization and Domestic Politics*. Eds. R. O. Keohane and H. V. Milner. Cambridge: Cambridge University Press, 25-47.
- Fox, J. (1991) *Regression Diagnostics*. Newbury Park, CA: Sage.
- Garrett, G. (1998) *Partisan Politics in the Global Economy*. Cambridge: Cambridge University Press.
- Garrett, G., and P. Lange. (1996) Internationalization, Institutions, and Political Change. In *Internationalization and Domestic Politics*. Eds. R. O. Keohane and H. V. Milner. Cambridge: Cambridge University Press, 48-75.
- Goodin, R. E. (1996) Institutionalizing the Public Interest: The Defense of Deadlock and Beyond. *American Political Science Review* **90**: 331-343.
- Grossman, G. M., and E. Helpman. (1994) Protection for Sale. *American Economic Review* **84**: 833-850.
- Hall, P. A. (1999) The Political Economy of Europe in an Era of Interdependence. In *Continuity and Change in Contemporary Capitalism*. Eds. H. Kitschelt, P. Lange, G. Marks, and J. D. Stephens. New York and Cambridge: Cambridge University Press, 101-134.
- Henisz, W. J., and E. D. Mansfield (2006) Votes and Vetoes: The Political Determinants of Commercial Openness. *International Studies Quarterly* **50**: 189-211
- Hirschman, A. O. (1970) *Exit, Voice and Loyalty*. Cambridge, MA: Harvard University Press.
- Hiscox, M. L. (2002) *International Trade and Political Conflict: Commerce, Coalitions, and Mobility*. Princeton, NJ: Princeton University Press.
- Hollinger, P., P. Marsh, C. Adams, and S. Laitner. (2006). UK Minister Attacks French Protectionism over Arcelor. *Financial Times* February 2: 15.
- International Monetary Fund (IMF). (various years) *International Financial Statistics Yearbook*. Washington, DC: IMF.
- Irwin, D. A. (2005) Trade and Globalization. In *Globalization: What's New?* Ed. M. M. Weinstein. New York: Columbia University Press, 19-35.
- Jones, B. D., and Baumgartner, F. (2005) *The Politics of Attention: How Government Prioritizes Problems*. Chicago: University of Chicago Press.
- Katzenstein, P. J. (1985) *Small States in World Markets*. Ithaca, NY: Cornell University Press.
- Kissinger, H. A. (2006) Anatomy of a Partnership. *International Herald Tribune*, March 11-12: 6.
- Lijphart, A. (1999) *Patterns of Democracy*. New Haven, CT: Yale University Press.
- Lohmann, S., and S. O'Halloran. (1994) Divided Government and U.S. Trade Policy: Theory and Evidence. *International Organization* **48**: 595-632.
- Mansfield, E. D., and M. L. Busch. (1995). The Political Economy of Non-Tariff Barriers: A Cross-National Analysis. *International Organization* **49**: 723-749.
- McGillivray, F. (2004) *Privileging Industry: The Comparative Politics of Trade and Industrial Policy*. Princeton, NJ: Princeton University Press.
- McKeown, T. J. (1984) Firms and Tariff Change: Explaining the Demand for Protection. *World Politics* **36**: 215-233.
- Milner, H. V., and B. Judkins. (2004) Partisanship, Trade Policy, and Globalization: Is There a Left-Right Divide on Trade Policy? *International Studies Quarterly* **48**:

- 95-119.
- O'Reilly, R. F. (2005) Veto Points, Veto Players, and International Trade Policy. *Comparative Political Studies* **38**: 652-675.
- Odell, J. S. (1990) Understanding International Trade Policies. *World Politics* **43**: 139-167.
- Organization for Economic Cooperation and Development (OECD). (2005) *International Investment Perspectives*. Paris: OECD.
- OECD. (various years) *Labour Force Statistics*. Paris: OECD.
- OECD. (various years) *National Accounts*. Paris: OECD.
- OECD. (2006a) *OECD Factbook 2006*. Paris: OECD.
- OECD. (2006b) *OECD Trade Statistics Database*. Paris: OECD.
- OECD. (2004) *Structural Analysis (STAN) Database*. Paris: OECD.
- Persson, T., and G. Tabellini. (2000) *Political Economics*. Cambridge, MA: The MIT Press.
- Polanyi, K. (1957) *The Great Transformation*. Boston: Beacon Books.
- Rodrik, D. (1998) Why do more Open Economies Have Bigger Governments? *Journal of Political Economy* **106**: 997-1032.
- Rodrik, D. (2005) Feasible Globalizations. In *Globalization: What's New?* Ed. M. M. Weinstein. New York: Columbia University Press, 196-213.
- Rogowski, R. (1989) *Commerce and Coalitions: How Trade Affects Domestic Political Alignments*. Princeton, NJ: Princeton University Press.
- Rogowski, R. (1987) Trade and the Variety of Democratic Institutions. *International Organization* **41**: 203-233.
- Soskice, D. (1999) Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s. In *Continuity and Change in Contemporary Capitalism*. Eds. H. Kitschelt, P. Lange, G. Marks, and J. D. Stephens. New York and Cambridge: Cambridge University Press, 101-134.
- Tullock, G. (2005) *The Rent-Seeking Society*. Ed. C. Rowley. Indianapolis, IN: Liberty Fund.
- Wooldridge, J. M. (2002) *Econometric Analysis of Cross Sectional and Panel Data*. Cambridge, MA: The MIT Press.
- Wren, C. (1996) *Industrial Subsidies: The UK Experience*. New York: St. Martin's.
- Zahariadis, N. (2003) *Ambiguity and Choice in Public Policy: Political Decision-Making in Modern Democracies*. Washington, DC: Georgetown University Press.
- Zahariadis, N. (2001) Asset Specificity and State Subsidies in Industrialized Countries. *International Studies Quarterly* **45**: 603-616.
- Zahariadis, N. (2005) Policy Networks, Elections, and State Subsidies. *Review of Policy Research* **22**: 115-131.
- Zahariadis, N. (2002) The Political Economy of State Subsidies in Europe. *Policy Studies Journal* **30**: 285-298.

Table 1

## The Determinants of Total Subsidies

	(1)	(2)	(3)
Labor Specificity (LS)	.018 (.004)***	.018 (.005)***	.016 (.006)***
Capital Specificity (CS)	.008 (.005)	.001 (.004)	.008 (.006)
Political Power	32.53 (12.84)**	30.97 (11.78)***	29.40 (12.01)**
Foreign Direct Investment (FDI)	.0028 (.010)	-.0028 (.010)	-.012 (.010)
Portfolio Investment	-.005 (.002)**	.001 (.003)	.004 (.003)
Trade Openness	.014 (.009)	.037 (.014)***	.049 (.011)***
Pluralism	-.686 (.274)**		
Electoral System		-.048 (.084)	
Collective Veto Points			.520 (.222)**
Competitive Veto Points			.354 (.21)*
LS * FDI	.0000 (.0001)	.0000 (.0001)	.000 (.000)
LS * Trade	-.0004 (.0000)***	-.0005 (.0001)***	-.0005 (.0001)**
LS * Portfolio	.00009 (00002)***	.0000 (.0000)	-.00004 (8.16e-06)***
CS * FDI	.0000 (.000)	.0000 (.0000)	.00009 (.00004)**
CS * Trade	-.0003 (.0001)**	4.18-e06 (.0000)	-.0001 (.0001)
CS * Portfolio	.0000 (0000)	-.0000 (.0000)	.000 (000)
Pluralism * Trade	.0154 (.006)**		
Pluralism * FDI	-.004 (.003)		
Pluralism * Portfolio	5.70e-07 (1.18e-06)		
Electoral System * Trade		.000 (.002)	

Electoral System * FDI		.000	
		(.000)	
Electoral System * Portfolio		-.0002	
		(.0002)	
Collective Veto Points * Trade			.0099
			(.0038)**
Collective Veto Points * FDI			.002
			(.002)
Collective Veto Points * Portfolio			.0008
			(.001)
Competitive Veto Points * Trade			-.0098
			(.005)*
Competitive Veto Points * FDI			.0007
			(.0017)
Competitive Veto Points * Portfolio			.001
			(.002)
Constant	-.403	-1.24	-1.87
	(.719)	(.634)*	(.76)**

---

Adjusted R-squared	.3248	.3103	.3483
Rho	.6452	.6799	.6265

---

Prais-Winsten estimates with robust standard errors in parentheses

N=173; \* .05<p<.10, \*\* .01<p<.05, \*\*\* p< .01, two-tailed

## Appendix

### Descriptive Statistics of Variables

Variable	Minimum	Maximum	Mean	Standard Deviation
State Subsidies*	.18	2.84	.86	.50
Trade Openness*	18.00	91.10	38.77	17.88
FDI Openness*	.13	163.27	7.62	14.10
Portfolio Openness*	1.01	201.30	19.51	32.87
Labor Specificity**	25.18	109.49	64.47	15.06
Capital Specificity**	13.85	123.67	42.88	22.86
Political Power***	.010	.062	.032	.012
Pluralism****	.50	3.50	2.09	1.11
Electoral System*****	1.29	18.65	5.32	5.16
Collective Veto Points*****	-1.39	1.66	.37	.95
Competitive Veto Points*****	-1.19	2.53	-.05	.93

\* Percent of GDP

\*\* Coefficient of variation in percent

\*\*\* Inverse of percent domestic market share taken up by imports

\*\*\*\* Index number

Source: European Commission (2006); OECD (2006a), *Labour Force Statistics (various years)*, *National Accounts (various years)*, and *STAN database (2004)*; Lijphart (1999); IMF (various years)

## ENDNOTES

---

<sup>1</sup> Comment made on the occasion of President Bush's visit to India in March 2006 (Kissinger 2006, 6).

<sup>2</sup> Comment made in opposition to French attempts to block corporate acquisitions by foreign conglomerates (Hollinger *et al* 2006, 15).

<sup>3</sup> The countries include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Holland, Portugal, Spain, Sweden, and the United Kingdom. Figures for all countries start in 1992 except for Austria, Finland and Sweden, which start in 1995.

<sup>4</sup> Labor specificity is measured as the annual averages of the absolute distance of wages from the mean wage in industry  $j$ , conditional on the number of employees and summed across 9 industries for which complete data exist. Capital specificity is the annual average of the absolute value added minus wage costs per employee as percent of capital per employee invested in industry  $j$  summed across 9 industries for which complete data exist.

<sup>5</sup> However, the variance inflation factors linking trade openness and political power (inverse of import penetration) approach problematic levels. I ran the equations omitting political power, but the results were identical. The coefficients of trade openness were in the same direction and statistically significant (or not) in the same equations. For this reason and because each indicator measures a different concept, I chose to include and report both variables. Because of multicollinearity among institutional variables, I estimate their effects separately and report three equations: one contains only pluralism, the other veto points, and the third disproportionality.

<sup>6</sup> In this case, there is also the possibility of endogeneity. Subsidies may theoretically affect future levels of exposure to globalization, i.e., trade, FDI, and portfolio investment. The time lags address this problem but don't fully answer it. Wooldridge (2002) recommends running two-stage least squares equations to explore the possibility of endogeneity. I did using instruments for the globalization variables and their interactions. The results did not change much; all variables had the same sign except for FDI and portfolio investment in one equation, but the coefficients increased in most cases. In light of the relatively small amounts of subsidies, total aid did not rise above 2.84 percent of GDP (Finland in 1995), it is unreasonable to expect subsidies to dramatically influence a country's international trade (or capital for that matter) position, whose average was 38.87 percent of GDP during the same period. For these reasons, I conclude that endogeneity is not a major problem in my data.

<sup>7</sup> The coefficients were calculated using the cluster option in STATA 9.0 Special Edition, which treats observations across units, but not within each unit, as independent. I also ran the analyses calculating panel-corrected standard errors and got essentially the same results.

<sup>8</sup> To take into account alternative explanations, I estimate the equations with two control variables. The literature makes a strong argument that demands for subsidies are more likely to intensify when the economy is weak or in a recession (e.g., McKeown 1984; Henisz and Mansfield 2006; Wren 1996). The government is likely to have a more sympathetic ear when growth is weak. Similarly, when unemployment is high, workers are more likely to lobby for protection. The first variable measures real annual economic growth. The second indicator measures standardized rates on unemployment. However, none of them prove to be statistically significant in the majority of equations. For this reason, I do not include the control variables in the reported equations.