

The Politics of Compensation under Trade: Openness, Economic Geography and Spending

Thesis Presented for Examination of Doctor of Philosophy (D.Phil)

Irene Menendez Gonzalez

Department of Politics and International Relations
Nuffield College

Irene Menendez Gonzalez
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Abstract

This thesis examines the conditions under which democratically elected policymakers are more likely to provide policies that compensate individuals that lose from international trade. It develops and empirically tests a theoretical framework of compensation in open economies that accounts for differences in the degree to which governments benefit losers from trade. It first develops a theory of preference formation based on economic geography, and argues that electoral and legislative institutions jointly condition the supply of compensation. The theoretical analysis provides three sets of observable implications evaluated using micro- and macro-level data in Europe and Latin America. First, exposure to international competition increases demand for policy that compensates for the costs of trade, but this effect is more pronounced among those individuals in economically specialised and uncompetitive contexts where reemployment in the event of a shock is difficult. Second, policymakers in proportional electoral systems face weak incentives to target trade losers in geographically concentrated and uncompetitive regions. In contrast, majoritarian institutions generate incentives to increase compensation when trade losers are geographically concentrated. Another implication is that under some conditions, the presence of a strong upper house that represents regional interests dampens the provision of compensation, and the relative effect of electoral rules.

The empirical implications of the argument are tested using a multi-method research strategy that combines cross-national and case study analyses together and draws on quantitative and qualitative techniques. Chapter 3 tests the micro-level implications of the model using survey data for European regions over 2002-2006. The findings indicate that regional economic specialization and regional competitiveness jointly condition the impact of trade on preferences for compensation. Chapter 4 systematically tests the extent to which the geographical concentration of trade losers conditions the effect of electoral institutions on levels of compensation. It uses panel data from 14 European countries from 1980 to 2010. The findings indicate that where trade losers are concentrated, lower district magnitude leads to more compensation. Chapters 5 and 6 conduct case studies of compensation in Spain and Argentina, both countries that underwent deep liberalisation and offer significant variation at the regional and institutional level. Chapter 5 explores preferences over compensation in selected regions in Spain and Argentina, and shows that regional specialisation and competitiveness were important in shaping levels of support for compensation. Chapter 6 examines the role of electoral institutions and legislative veto bargaining in shaping the politics of compensation in Spain and Argentina.

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Compensation in open economies

Why do some governments compensate losers for the adverse effects of international trade, while others reward winners, often exacerbating distributive conflict and inequality? Standard explanations in comparative and international political economy often claim that globalization increases demand for social protection that compensates individuals for the costs of trade, and corporatist, electoral or economic institutions influence the responsiveness of governments concerned with political survival. In such models, the preferences of those than stand to lose from trade are generally stable, and institutional configurations mediate such preferences to produce policy that variously benefits losers. Yet levels of spending on compensation across and within countries vary widely for given levels of trade exposure.¹ Equally importantly, individual preferences for compensatory measures vary *within* countries. As will be shown in later chapters, differences in support for compensation exist between individuals exposed to trade across regions in a given country, suggesting that the effect of trade may be dependent on previously overlooked contextual factors. In fact, data assembled in Chapter 3 show that two individuals working in the same occupation and the same sector are likely to support different levels of compensation depending on regional structure.

Such differences in attitudes and spending patterns speak to fundamental distributive conflicts at the heart of democratic societies. They reflect the ability of particular economic groups to impose their preferences on other groups in a context of structural

¹ Regressing levels of unemployment benefits on a measure of imports (% GDP), exports (% GDP), a battery of socio-demographic variables (capita GDP, employment in industry, unemployment rate, the share of population in employment, period dummies and country fixed effects) in a sample of 14 European countries over the period 1980-2010 yields an R-squared of 0.27. This leaves a substantial amount of residual variation to be explained. Studies focusing on developing countries have also found striking variation (Wibbels 2006, Etchemendy 2011, Rickard 2012).

change, marked by economic uncertainty and subject to shocks. Conflict between those that win and lose from trade has characterized public policy reforms across developed and developing political economies. Those that win from trade have incentives to oppose a policy that targets resources to trade losers at their expense. Compared to those that lose from trade, they benefit little from policies that foster reemployment, as the risk of unemployment among such individuals is relatively low, but contribute to pay for such policies. Policies such as unemployment benefits or active labour market policies compensate for the risk of income loss, and constitute an important share of countries' social expenditure.² While in some cases trade losers may have strong reasons to support compensation, in other cases they prefer lower levels of compensation – and in the extreme, may resemble winners. This has implications for policymakers struggling for political survival. Although in some cases governments have strong incentives to target trade losers, often they have to take into account the preferences of a broader electorate. This is further complicated by the existence of veto players in the national policymaking process, which may have preferences that go in the opposite direction. In open economies, heterogeneous economic groups and institutions governing political behaviour shape how governments allocate the costs of trade. Thus, whether losers from trade are able to impose their preferences on other groups depends on the extent of economic heterogeneity and the distribution of political power.

This research addresses these questions. It develops and tests a theoretical framework of compensation in open economies that accounts for differences in the degree to which governments benefit losers from trade. It provides three key insights. First, individuals in losing sectors highly exposed to competition often are less supportive of compensation than typically thought. While exposure to international competition may

² As will be argued in Chapter 2, “compensation” may have many dimensions. The focus of this research is on those social policies that address labour market risk.

increase demand for policy that compensates for the costs of trade under certain circumstances, it need not do so. Greater exposure may strengthen demand for compensation in regional contexts where reemployment in the event of a shock is difficult. In regions where individuals are able to find employment relatively easily, the risk of income loss is dampened and demand for compensation diluted. Most countries exhibit significant regional economic heterogeneity. Under conditions of strong heterogeneity – that is, under conditions that are common in developed and developing economies – disagreements over the desired level of policy *among* trade losers drive (or mute) political conflict.

A second insight is that in the presence of such different demands, policymakers in proportional electoral systems face weak incentives to target trade losers. Under some conditions, proportional electoral rules typically associated with greater levels of social spending generate political incentives to reduce spending on compensation. Policies such as unemployment benefits or active labour market policies, defined in this research as compensation, constitute important items of social spending. While in some cases proportional systems may lead to increases in compensation, in others they may not do so. Proportional rules lead to similar or slightly higher spending than majoritarian rules when regional economic differences among trade losers are diluted – namely, when trade losers are geographically dispersed – and disagreement over the level of policy is dampened. But proportional rules decrease compensation relative to majoritarian rules when its beneficiaries are geographically concentrated. Geographical concentration of trade losers exacerbates divisions over the level of compensation. When regional economic differences between trade losers are significant, disagreements among trade losers lead governments elected under proportional rules to provide less compensation to those that need it most. A last insight concerns the role of veto bargaining in shaping the

effect of electoral institutions. When regional interests represented in a strong upper house have the capacity to influence national policymaking, the role of electoral rules is dampened. In the presence of an upper house with legislative authority, electoral institutions may make less of difference to the provision of compensation.

1.1 The argument

Chapter 2 provides the theoretical framework guiding the empirical analysis.

Analytically, the purpose of the chapter is to identify the features that strengthen the influence of trade losers on policymakers deciding over compensation. The focus is on those policy areas specifically designed to compensate for the loss of income: unemployment benefits and active labour market policies. These policies directly address the risk of income loss in the event of a shock. The argument developed in Chapter 2 suggests that compensation policies are the result of changes in the bargaining power of trade losers vis-à-vis elected policymakers. The decision-makers comprise policymakers at the national level as well as policymakers at the regional level represented in the national legislature (lower and upper house, respectively). The degree to which policymakers respond to the demands of trade losers depends on the incidence of demand for compensation, and the incentives generated by institutions to target geographically defined constituencies.

The argument starts from the premise that not all individuals that stand to lose from trade are equally *losing*. In open economies, individual interests are shaped by the level of income from trade and the variability of returns. The extent of uncertainty is contingent on features of the regional environment that ease or hinder mobility across sectors in the event of job loss. Specifically, regional economic specialization and export competitiveness jointly shape the ease with which losing factors are able to get a job in a

winning sector in the event of a shock. For instance, consider individuals employed in losing industries in economically specialized and uncompetitive regions. Whether employed in import-competing industries or owners of scarce factors, individuals suffering income losses are expected to support greater compensation. But in the event of a shock, regional specialization decreases mobility between sectors, and low regional competitiveness constrains the capacity of employers to absorb labour. This sharply increases labour market risk and drives demand for compensation. Relative to such individuals, similar individuals in regions with a diversified industrial base benefit from greater outside options. Individuals employed in losing industries in competitive regions are expected to demand relatively low levels of compensation. Those in diversified and competitive regions face greater outside options and benefit from the employment effects of diversification, which all else equal dampens support for compensation. In specialized regions, positive externalities and high competitiveness dampen labour market risk, but limited mobility increases support for compensation. Thus, while income effects of trade matter, particular features of the regional environment condition the effect of trade on demand for compensation.

Given such differences between workers affected by trade, the argument then claims that the effect of electoral and legislative institutions on policy is contingent on the underlying structure of demand for compensation. Echoing arguments in international political economy, it claims that national policymakers in systems governed by majoritarian electoral rules have stronger incentives to provide compensation when losers from trade are geographically concentrated (Rickard 2012b, Barber 2014). Policymakers under plurality have incentives to target voters in particular districts. Because trade losers that are geographically concentrated face comparatively higher levels of risk relative to dispersed ones, trade losers in such districts also demand greater

levels of policy. In the presence of such high demanders, plurality is likely to translate into higher levels of compensation.

In contrast, policymakers under proportional rules are dependent on the national vote share to win re-election and are thus less likely to focus on particular constituents (McGillivray 2004). Even if concentrated trade losers demand greater spending, catering to such interests is unlikely to increase policymakers' chances of re-election. Finally, the presence of geographically dispersed trade losers dampens differences between electoral rules. Where trade losers are geographically dispersed, politicians under plurality have lesser incentives to increase spending, as distributing benefits without geographic discrimination is not likely to increase their electoral rewards. However, the presence of dispersed losers dampens demand for compensation, so that even policymakers under PR have lesser incentives to increase spending.

Lastly, the theory extends the logic to cases where regional interests are represented in the national policymaking process. It draws on insights from the literature on veto players in comparative politics (Tsebelis 2002, Cameron and McCarty 2004, Beramendi 2012) and emphasizes that the presence of a strong upper chamber generates institutional veto players with incentives to respond to particular interests. The presence of an upper house with legislative authority leads to lower levels of compensation relative to where the former does not exist, and this should hold for both majoritarian and proportional rule.

Before delving into the research design, it is important to highlight the scope conditions of the research. On a broad level, the argument first and foremost applies to economically open, relatively industrialised democracies. It applies to democracies that have opened to trade and face likely trade shocks as a result. It thus excludes countries with no electoral turnover, and should not apply to democracies that transit from autarky

to trade, as in such cases trade openness is likely to be endogenous to the provision of compensation, and likely to trigger different political calculations (Adsera and Boix 2002, Boix 2006). It also applies to countries with sufficient levels of industrialisation. Since the argument is concerned with the existence of alternative employment within the manufacturing sector, it should travel less well to countries (and regions) that have a relatively low industrial density. In terms of time period, the argument is likely to apply to the post-1945 period, characterised by a secular increase in trade openness among democracies, where democratically elected governments were forced to manage the consequences of increased exchange. It should apply in particular to the period that followed the oil shocks, which triggered a wave of liberalisation in trade regimes (and in particular, manufacturing) that increased political pressures to compensate losers.

As regards *types* of policies, the argument applies to social policies that target labour market risk. Governments may resort to a number of policies in order to compensate trade losers. This research focuses on social policies that target labour market risk and that are by many standards universal, programmatic policies, and thus apply to most citizens regardless of age, occupation and location. This includes policies such as unemployment benefits and active labour market policies, and excludes policies such as trade protection (subsidies and tariffs) that can be more narrowly targeted to particular voters. Policies such as unemployment benefits and active labour market programmes are largely concerned with reemployment. The argument thus specifies the micro-foundations of policies that compensate for trade from the perspective of *reemployment* and emphasises regional factors associated with reemployment likely to drive demand for such policies. Because of this, it is likely to travel less well to other compensation policies such as trade protection, which may differ in the micro-foundations.

The argument also focuses on one dimension of risk, that of income loss, at the expense of many others, such as disability, sickness or old age. While these risks are also worth exploring, they require taking into account the existence of a private alternative to publicly provided compensation (Moene and Wallerstein 2001). Because the politics of demand for insurance in the presence of a private alternative involve different considerations, the research purposefully excludes this.

Lastly, the research focuses on changes in competitiveness driven by international – not domestic – trade. Admittedly, although exports are widely seen as triggering multiplier effects and driving development, they are not the only factor driving competitiveness. In large countries like the US, where regions trade internally and exports represent relatively low levels of GDP, internal productivity is likely to make a difference in terms of employment growth and development (Krugman 1996). The relevance of domestic productivity for competitiveness depends on the size of the country and its openness to international trade. In a small country dependent on tourism or fishing, the competitiveness of exports shapes the level of employment and income, as well as imports. In European and most Latin American countries, much more open to international trade than the US, firms sell both on the internal and the international markets, and thus internal productivity and export competitiveness “sound much more similar” (Camagni 2002: 2400). This suggests that the opportunity costs of non-trading internationally are likely to be large enough as to blur the line between internal and external productivity even in countries that trade domestically. Nonetheless, specifying demand for compensation in a context of domestic trade involves other considerations, such as regional mobility, and one model cannot encompass everything.

Relatedly, the research focuses exclusively on the effect of increased trade of goods on competitiveness. However, in reality governments have a number of macroeconomic policies at their disposal to affect market returns under economic openness, thereby shaping levels of competitiveness at the individual and at the territorial level.

Government policy over anything ranging from trade to exchange rates is likely to mediate the returns to individuals of changes in relative prices. Prominent research on market reform in Latin America argues that appreciation of the exchange rate put competitive pressure on export-oriented producers (Frieden 1991), driving demand for protection. As Chapters 5 and 6 will show, this was apparent in Argentina in the aftermath of the debt crisis, where export-oriented producers of primary products and resource-based manufacturing suffered from currency appreciation designed to combat hyperinflation. Arguably, however, research on the exchange rate change suffers from some ambiguity when it comes to predictions on the effect of exchange rate change on returns to factors of production.³ This makes the task of theorizing the effect of exchange rate change in the context of liberalization difficult. Acknowledging that this may be a limitation, the study of trade liberalization and exchange rate change is left for future research.

1.2 Research design and findings

The argument has a number of novel observable implications. At the micro-level, it predicts that demand for compensation should vary depending on levels of regional specialization and competitiveness *among* individuals employed in losing industries. At

³ On the one hand, currency appreciation may affect the balance of trade preferences by increasing imports and decreasing exports (Mansfield and Busch 1995). This would imply increased demand for compensation among affected factors. However, other research suggests that the effect of the exchange rate may have little impact. Rodrik (1994: 73) shows that a devaluation (the opposite of an appreciation) increases the domestic price of both imports and exports, thus allowing both import-competing and export-oriented sectors to benefit. But under certain conditions – when foreign exchange is limited – devaluations may work like trade liberalization, prompting demands for protection and/or compensation from import-competing sectors (Milner 1999).

the macro-level, it predicts that compensation outcomes should vary depending on the extent of regional specialization, regional competitiveness and electoral and legislative institutions. Testing these predictions thus implies a comparison between individuals across regions and among countries exposed to international competition. One challenge underlying the research design is that some of the necessary data is not available cross-nationally or sub-nationally for the period of study. Another is that the more fine-grained implications of the argument require careful examination of causal mechanisms. To address this, the empirical research is carried out in four chapters and relies on a mix of cross-national and case study analyses that combine quantitative and qualitative techniques. In the cross-national quantitative analyses, the focus is on European countries simply because panel data is available both at the regional and the national level. Chapter 3 explores survey data in European countries to test the micro-level implications of the theory. Chapter 4 looks at the relationship between geographical concentration, institutional setting and policy outcomes in a panel of European countries. Chapters 5 and 6 complement the quantitative analyses with in-depth studies of preference formation across selected regions in Spain and Argentina, and of policy outcomes in the two countries.

Combining quantitative and qualitative methods, cross-nationally and within country, achieves a number of goals. Firstly, cross-national large-N analyses of survey and macro-level data test the argument across a large panel of countries. This generalises the argument across a wide sample of countries, and makes it possible to use a number of techniques that improve causal inference (Angrist and Pischke 2009). Secondly, controlled comparison of preference formation and policy processes, within country and cross-nationally, makes it possible to maximise theoretically driven variation and control (Slater and Ziblatt 2010, Brady and Collier 2010). Within-country studies of Spain and

Argentina rely on a comparison between selected regions. The subnational focus makes it possible to control for a wide array of national-level factors (such as existing levels of compensation, Catholicism, etc.) that could plausibly influence demand for compensation. In turn, an in-depth analysis of policy outcomes across both countries seeks to explain outcomes in compensation within the two cases.⁴ It also addresses some of the more fine-grained aspects of the theory that cannot be measured cross-nationally (such as the preferences of regional veto players). Finally, the use of different kinds of methods enables their “triangulation” and increases inferential leverage (Tarrow 2010). The appendix to Chapter 5 includes a brief description of the methodology employed when conducting interviews as well as a list of interviewees.

Why Spain and Argentina? The two countries represent significant variation in the main explanatory factors of the argument. If the argument developed in Chapter 2 is valid, it should be able to explain outcomes in the demand and supply of compensation in the two cases. Both Spain and Argentina are characterized by significant regional economic heterogeneity, and display strong variation in the geographical distribution of trade losers over the period of study. Both also exhibit strong differences *within* regions, with some industrial regions much more dependent than others on losing interests. Such regional variation at the onset of liberalization makes both countries good candidates for comparison. Secondly, Spain and Argentina differ in the degree to which regional interests are represented in the national policymaking process. Policymakers in Spain are elected under proportional electoral rules, and the second chamber has very limited influence in national policy-making. In Argentina, policymakers in the lower house are also elected under PR, but its strong upper chamber represents regional interests.

⁴ Thus, even though the analysis of Spain (or Argentina) provides internally validity in the specific cases, the case studies also provide qualitative tests of the argument’s external validity (Slater and Ziblatt 2010: 1311).

Argentina thus constitutes a clear example of a bicameral system with a strong upper house, where regions can steer national policy towards their interests by virtue of their political weight in the national policymaking process. Chapter 6 discusses this in more detail.

In addition to maximising variation, Spain and Argentina were selected to control for existing rival hypotheses (Slater and Ziblatt 2010). Theories of compensation under trade would view Spain as a likely case for compensation given the presence of social democratic government and, to a lesser extent, strong labour movement (Boix 1998, Huo et al. 2008, Garrett 1998). In turn, arguments in political economy would suggest proportional representation to lead to increases in compensation (Persson and Tabellini 2000, 2003). Despite this, spending on compensation in Spain was comparatively lower than other items of social spending. In turn, research on social spending in developing countries would regard Argentina as an unlikely case for compensation given its vulnerability to international business cycles, expected to depress overall social spending (Wibbels 2006), the presence of powerful labour interests with a preference for policies that catered to labour insiders at the expense of outsiders (Etchemendy 2011, Murillo 2001), or the presence of tradable sectors that demand policies that enhance economic competitiveness (Wibbels 2006). As Chapter 6 will show, structural dependency did not prevent increases in social spending, nor did powerful labour interests prevent policymakers from targeting outsiders. In turn, Chapter 5 suggests that tradables demanded policies that compensated for the costs of liberalisation. That neither government behaved according to how prominent explanations predicted they would underscores the importance of integrating economic geography and political institutions in the demand and supply of compensation.

In addition, most analyses reflect a concern with exogenous variation.⁵ One of the principles guiding the research is that countries face externally given conditions – related to openness – to which they formulate policy responses in terms of compensation. However, if changes in relative prices are driven by the policies of countries themselves, external conditions could not be taken as given. For instance, many discussions of compensation assume that trade liberalization is entirely driven by a given country – for instance, when a country chooses to open and subsequently compensates, or compensates as a precondition to liberalizing.⁶ Without denying the importance of domestic factors in the process of liberalization, an underlying assumption throughout the research is that the decision to liberalize is in no small part exogenously determined. This is not uncommon in studies of compensation under trade. The reduction of barriers to trade in developed and developing countries can be traced to the early 1980s, and was largely a response to global economic crisis.⁷ The 1974-75 oil price shock precipitated a deep crisis in the European steel industry, which extended to the whole of manufacturing, traditionally the sector most exposed to trade, in many European countries. The quantitative analysis of European countries in Chapter 4 covers the period 1980-2010 and thus reflects these trends. The choice of case studies also addresses this. In Spain, trade liberalization was in large part a result of changes in the oil price that followed the 1974-1975 shocks as well as European Union membership negotiations. In addition to tariff reductions associated with membership, the conditions for membership were particularly stringent in the industrial chapter, and committed Spain to substantial capacity reduction. Interview material also makes it possible to make the case for international pressures by asking whether trade liberalisation and

⁵ With the exception of Chapter 3, where the concern to maximize regional variation implied analyzing patterns of demand in a period where exposure to trade was not fully exogenous.

⁶ For examples of this, see Adsera and Boix 2002, Boix 2006.

⁷ With the exception of the Middle East, most other countries in Europe, Latin America, Africa and Asia reduced trade barriers (Bourguignon and Pleskovic 2005).

industrial restructuring would have occurred in the absence of international pressures. As shown in Chapter 5, it is unlikely that domestic economic factors would by themselves have triggered industrial restructuring.

In Argentina, the decision to liberalize trade was also largely tied to international developments. It is difficult to imagine structural reforms – among which, trade liberalisation – in Argentina in the absence of the credit crunch of the 1980s. Prominent research has emphasized that the debt crisis that gripped much of the Latin American continent was fundamentally exogenous to domestic spending patterns, because the supply and price of international finance were shaped by factors other than domestic policies (Frieden 1991). Further, acceptance of structural adjustment programmes supported by international financial institutions implied a reduction of trade barriers as well as reform in many other areas.⁸ In line with this, interviews with a number of policymakers and experts revealed that the decision to liberalize the economy in the late 1980s was driven by pressure from international financial institutions and by policy convergence in the region. This echoes recent research emphasising the role of international diffusion processes in triggering policy reform (Meseguer 2004, Meseguer and Gilardi 2009, Doyle 2010).⁹ Other scholars have emphasized that domestic economic conditions, such as the presence of very high levels of inflation or deficit and debt, put governments under increasing pressure to reform (Haggard and Kaufman

⁸ Khan and Knight (1985) distinguish between a macro-economic (stabilizing) and a structural adjustment component in the typical IMF programme. The macro or demand management package is mainly based on restrictive monetary, fiscal and domestic credit policies, aimed at eliminating the disequilibrium between aggregate demand and aggregate supply, improving the current account and reducing inflation, with special control on the reduction of fiscal deficits. The structural adjustment or resource allocation component usually includes 3 main policy blocks: trade liberalization, financial reform and major devaluation including exchange rate unification where multiple rates exist. The goal of the adjustment component is to “increase efficiency, raise investment and enhance growth opportunities” (Edwards, 177).

⁹ Meseguer (2004) argued that the initial decision to privatize was heavily shaped by both processes of rational learning and emulation. Doyle (2010) argues that while the initial decision to reform was shaped by international factors, the extent and intensity of reform are shaped by domestic factors.

1995).¹⁰ Arguably, while domestic economic and political variables may facilitate or hinder the adoption of policy, they cannot explain why so many states adopted similar policies at the same time. Thus, at least some part of the decision to liberalize may be viewed as exogenous to domestic politics.

Chapter 3 tests the micro-level implications of the model using survey data for European regions for the period 2002-2006. It brings together individual, sector and regional level data and analyses the data using a three-level multilevel model with random intercepts. The findings indicate that regional economic specialization and regional competitiveness jointly condition the impact of trade on preferences for compensation. The analysis shows that support for compensation is highest among individuals employed in losing industries in specialized and uncompetitive regions, and is dampened among similar individuals in diversified regions.

Having established the conditional impact of exposure to foreign imports on individual preferences, Chapter 4 explores the macro-level implications of the argument, and addresses how institutional arrangements translate preferences into policy outcomes. It first explores the extent to which the geographical concentration of trade losers conditions the effect of electoral institutions on the generosity of compensation. It relies on annual data from 14 European countries from 1980 to 2010, and employs a fixed-effects estimator with clustered standard errors. The findings indicate that where trade losers are concentrated, lower district magnitude leads to more compensation. In contrast, where trade losers are dispersed, the effect of electoral institutions on compensation is dampened. Secondly, the analysis also explores how the presence of a strong upper chamber conditions the effect of electoral institutions for given levels of demand. The findings confirm the importance of regional legislative authority in shaping

¹⁰ This, however, is at odds with the experience of the Alfonsín government in Argentina, which faced with very high levels of internal deficit and external debt and failed to reform.

the effect of electoral institutions. They indicate that in countries with extensive regional authority, the effect of electoral rules on compensation is dampened.

Chapters 5 and 6 shift the method of inquiry from cross-national statistics to case studies. Chapter 5 carries out an in-depth case study of preference formation in Spanish and Argentine regions. Chapter 5 explores variation in preferences over compensation in selected regions in Spain and Argentina, asking why individuals affected by trade preferred greater levels of compensation in some regions and not others. Statistical analyses show that individuals in uncompetitive and specialised regions were much more likely to demand compensation than those in diversified regions. An in-depth study of selected regions complements the quantitative analysis. It fleshes out developments in regional labour markets in both countries and illustrates that regional features were important in shaping demand for compensation. For both, the sub-national focus provides variation and makes it possible to control for country-level characteristics.

Chapter 6 shifts the focus to the national level and conducts an in-depth examination of the politics of compensation in Spain and Argentina. The chapter fleshes out the social, political and economic context in which national politicians operate, and pays attention to some aspects that are not easily quantifiable, such as the preferences of regional politicians in national policymaking. The chapter examines the role of electoral institutions and legislative veto bargaining in shaping the politics of compensation. The analysis illustrates that in Spain, the existence of proportional rules, where all votes matter, induced policymakers to cater to a broader electorate at the expense of concentrated trade losers. In Argentina, the presence of a strong upper chamber dominated by relatively low-demanding regions induced policymakers to provide low levels of compensation. Chapter 6 also highlights how compensation plays out in the

absence of regional dynamics by exploring the distribution of funds that are not subject to legislative bargaining in a context where the chief executive is elected under plurality rule. Consistent with the logic of the argument, it illustrates that when unconstrained by regional veto players, policymakers elected under plurality rule in systems with low magnitude cater to trade losers in concentrated uncompetitive regions. Chapter 7 concludes by summarizing some of the main insights and indicating avenues for future research.

1.3 Relation to literature

The growth of economic interdependence in past decades has triggered a wealth of research studying the consequences of trade exposure for social policy in democracies. This research bridged economists and political scientists, and has generated clear-cut theories and made significant empirical efforts to test them, producing a rich set of empirical findings. In a seminal article, Cameron (1978) found that economic openness was associated with increases in public spending for a sample of OECD countries between 1960 and 1975. This was complemented by rich qualitative studies exploring the complex interrelationship of small European economies in a period of heightened economic exposure (Katzenstein 1985, Kurzer 1993). Drawing on such insights, later research emphasised the role of aggregate volatility associated with open economies in driving public support for public expenditure (Rodrik 1997, 1998, Garrett and Mitchell 2001). These studies argued that price volatility in open economies generates economic risks that lead individuals to demand policies that compensate for such risks. The “compensation hypothesis”, as it was labelled, was countered by research arguing that even if economic exposure triggered demands for compensation, it also constrained the ability of the state to provide it (Steinmo 1994, Kurzer 1993, Rodrik 1998). The “efficiency hypothesis” claimed that welfare spending had adverse effects on economic

competitiveness, while capital mobility in response to high payroll taxes capped welfare spending.

However, this first generation of research only partially explained observed differences in levels of compensation across and within countries, and led to new questions (Iversen and Cusack 2000, Huber and Stephens 2001, Adsera and Boix 2002). More recent research focuses on the sources of risk driving demand for compensation, such as skill specificity or sector of employment (Rickard 2006, Rehm 2009, Walter 2010).¹¹ As will be emphasised in Chapter 2, however, a common factor underlying accounts of risk – whether defined at the occupation or sector level – is the ease with which workers are able to find alternative employment. Individuals are employed in industries that are nested in regions, and there are strong reasons to think that industries in a region are subject to spatial interdependencies that may help reemployment to varying degrees. Yet relatively little attention has been paid to the *geographical* dimension of risk, or the extent to which contextual characteristics shape mobility across sectors in the event of job loss.¹²

In parallel, prominent accounts of social and industrial policy in open economies emphasise the distributional effects of trade to account for differences in individual preferences over policy. Such models rely on workhorse models of international trade that predict support for trade policy on the basis of an individual's position in the international economy. Depending on the assumptions that are made about factor mobility, some individuals lose in real terms as a result of greater trade while others win (Stolper-Samuelson 1941, Ricardo-Viner 1971). Trade models provide a solid basis on which to derive predictions about individual behaviour. But such models also make

¹¹ Exploring the determinants of trade protection, Rickard (2009) provides a closely related argument on adjustment costs of trade, which reflect labour specificity.

¹² One exception is Barber (2014), who claims that the presence of service sector workers in specialised regions with prominent industries in decline drives demand for trade protection.

strong assumptions about individual utility, and overlook important sources of individual heterogeneity – ranging from other-regarding preferences (Lu, Scheve and Slaughter 2012) to economic context (Mansfield and Mutz 2009, Barber 2014). Moreover, they would appear to be at odds with recent findings emphasising varying levels of support for trade liberalisation from groups of voters who, on an income basis, would be expected to oppose it (Kingstone 1999, 2001, Baker 2005, 2010, Mansfield and Mutz 2009).¹³ This is particularly the case in research on developing countries, where entrenched interests hostile to trade liberalisation after decades of inward-oriented growth strategies are expected to demand increased compensation (Rudra 2002, Wibbels 2006, Etchemendy 2011).¹⁴ As shown by recent studies (Kingstone 2001, Baker 2010), however, there is reason to expect substantial variation in individual support for free trade. This suggests that the sources of support for compensation are also likely to vary. With some exceptions, the sources of support for compensation under trade remain largely underspecified.

On the supply side, a broad literature explores how different institutional arrangements aggregate preferences for compensation. Unconvinced by the absence of political mechanisms underpinning the efficiency hypothesis, a first wave of research emphasised the role of domestic political institutions in shaping the level of social spending, from encompassing corporatist institutions (Garrett 1998, Rudra 2002, 2005) to partisanship (Boix 1998), electoral systems (Swank 2002, Hays 2009), veto players (Ha 2008) or regime type (Adsera and Boix 2002). These studies have produced valuable insights, but many do not explicitly model variation in demand. Rather, many of these studies assume – given risk-based arguments – the existence of greater demand for compensation

¹³ This echoes recent research on preferences for redistribution (Rueda and Stegmüller 2013).

¹⁴ Recent research also explores variation in the type of compensation in developing countries (Etchemendy 2001, 2004, 2011, Murillo 2009, Rickard 2012).

(Rudra 2002, Garrett 1998) among the “increasing ranks of the economically insecure” (Garrett 1998: 10). Exceptions aside, most research on comparative political institutions has under-theorized the economic conditions under which political institutions shape the level of compensation.

Recent research in international political economy offers one important exception. Studies on trade protection suggest that electoral institutions generate political incentives to target geographically defined voters with a preference for protection (McGillivray 2004, Rickard 2009, Rickard 2012b, Barber 2014). Arguments in this literature highlight that the interaction of demand associated with greater risk (linked to mobility and/or regional structure) and institutional rules associated with different geographical bases shapes an important aspect of compensation in open economies, namely, trade protection. For instance, Rickard (2012b) argues that majoritarian rules lead politicians to provide more manufacturing subsidies than proportional representation systems (PR) when employment in manufacturing is geographically concentrated. Because the benefits of subsidies are concentrated in a given district and the costs are spread across taxpayers, “subsidies are... an efficient way for incumbent politicians to maximize their chances of re-election in plurality systems when voters with an economic interest in subsidies are geographically concentrated” (Rickard 2012b: 860). In contrast, policymakers in systems governed by PR will be more responsive to interests demanding such “narrow” transfers when the latter are geographically dispersed. Together with a growing literature in comparative political economy, such studies constitute fruitful attempts to explore the conditions under which institutions are more or less likely to matter in the provision of policy.¹⁵

¹⁵ A growing body of research emphasises the need to take economic heterogeneity into account when theorising the effect of political institutions (Rodden 2010, Beramendi 2012, Wibbels 2005).

The present research builds on this recent strand in the literature. However, arguments on trade policy do not seamlessly apply to compensation policies. The factors that drive policymakers to provide compensation in *given* geographical and institutional settings may be different from those that induce them to provide trade protection. In particular, the micro-foundations underpinning the former are likely to differ from those of trade protection. Whereas protection is concerned with maintaining employment, unemployment benefits and active labour market policies are largely concerned with *reemployment*. Because of this, contextual factors associated with reemployment, such as regional economic structure, are likely to play a significant role. In addition, arguments in comparative political economy suggest that the presence of legislative vetoes is likely to shape the impact of electoral rules (Cameron and McCarty 2004). To the extent that upper chambers represent regional interests, the politics of compensation are likely to play out differently relative to where second chambers do not exist. Finally, extending the territorial logic of electoral institutions to nominally programmatic spending items is likely to provide insights on the effect of electoral institutions. Unlike “narrow” transfers such as trade protection, unemployment benefits or activation programmes arguably address relatively common situations without geographic discrimination. To the extent that political incentives to target geographically defined interests “bind”, testing the effect of electoral institutions on compensation should be somewhat of a hard test.

The argument put forth in this research suggests that economic geography has an important but previously overlooked role in shaping compensation in open economies, both through its effect on the demand and the supply of policy. By doing so, it provides an account of compensation in open economies that aims to improve on the current literature in a number of ways. First, it seeks to provide an argument that specifies the

drivers of demand and supply of compensation. Although many studies bring together demand and supply factors, few have actually modelled the factors that drive demand and supply simultaneously. Second, by explicitly unbundling the ties that bind international competition and preferences for compensation, it seeks to provide a more complete picture of the factors driving demand for policy. Specifically, by specifying a conditional effect of trade at the regional level, it nuances existing arguments that posit the existence of a generalised (positive) relationship between trade and demand for compensation. This places it squarely in line with research emphasising the importance of preference heterogeneity in shaping policy outcomes (Beramendi 2012, Rickard 2006). Third, the argument suggests that that under certain conditions, the relationship between institutions and social spending may run counter to conventional views (Persson and Tabellini 2000, 2000, Milesi-Ferretti et al. 2002). This echoes research on trade protection (Rickard 2012b, Barber 2014), and suggests that, as regards spending on compensation in open economies, the effect of proportional rules is contingent on the geographical distribution of its beneficiaries. Despite this, however, the argument also suggests that the presence of a strong upper house may dampen the role of electoral institutions on the provision of policy.

Finally, although the focus is on the specifics of trade liberalization in developed and developing countries, the research also contributes to the more general question of the conditions under which the geographical distribution of the costs and benefits of policy helps policy change in the context of structural reforms. In addition, it has implications for our understanding of democratic politics in open economies. It emphasizes that in the presence of conflict between those that stand to lose from trade, democracies do not necessarily promote the interests of those that need it most. Given the increasingly

integrated nature of most economies, this has implications for the sustainability of institutions in representative democracies.

Trade exposure and compensation: an economic geography argument

This chapter analyses the adoption of compensatory policy in the aftermath of trade openness as the joint outcome of demand for policy associated with structural economic conditions and the supply of policy linked to a set of institutional mechanisms. It proceeds in two steps. It first offers a risk-based argument on preference formation and assumes that individual interests are shaped by the expected level of returns from trade and by the variability of returns (or risk). Shocks in open economies may generate uncertainty in income streams, and the extent of uncertainty is contingent on contextual factors. Analytically, uncertainty is driven (at least in part) by the ease with which individuals are able to find alternative employment within a region in the event of a shock.

Drawing on insights from endogenous growth theory and economic geography, the argument posits that regional specialization and competitiveness jointly shape the ease with which workers employed in losing industries are able to get a job in a winning sector. This in turn shapes demand for compensation. Regional specialization of economic activity affects labour mobility between sectors in a region in different ways. Specialization may decrease mobility by reducing outside options and increasing the risk of regional downturn, but may also foster employment growth among industries. The argument below claims that whether one effect prevails over another depends on levels of competitiveness, defined as the average export performance of a region. The more competitive a region, the easier it will be for workers to find alternative employment. In the event of a shock, losing workers in specialized uncompetitive regions may wish for very high compensation, while those in uncompetitive regions with a more diversified industrial base may exhibit some demand for compensation.

Secondly, the chapter argues that electoral institutions interact with a given structure of regional preferences to shape policy outcomes. Building on arguments in political economy and comparative politics, the argument first distinguishes between electoral systems that cater to geographically defined interests and those that target more general interests. It claims that the effect of electoral institutions on policy is contingent on the underlying structure of demand for compensation. At high levels of demand for compensation, policymakers elected under majoritarian rules will tend to benefit interests that lose from trade to a greater extent. At low levels of demand, electoral institutions translate into lower levels of compensation, across PR and majoritarian systems.

The argument then extends the logic to encompass the role of veto players in driving policy outcomes. Building on insights from the literatures on federalism and veto players in comparative politics, it emphasizes that the presence of a strong upper chamber in federal systems generates institutional veto players with incentives to respond to particular interests. This has key theoretical implications. Where regional veto players prefer lower levels of compensation, the presence of a strong upper chamber dampens levels of compensation. This also means that electoral rules may matter less for policy outcomes, which are driven to a larger extent by veto bargaining between legislative bodies.

In contrast, where regional veto players prefer higher levels of compensation, the existence of an institutional veto does not lead to changes in compensation relative to where a second chamber does not exist. Policy outcomes are driven to a larger extent by the effect of electoral rules. At high levels of demand, policymakers elected under majoritarian institutions provide greater compensation relative to those elected under

proportional rules. At low levels of demand, policymakers elected under either PR or majoritarian rules provide similar (low) levels of compensation.

2.1 Why it is necessary to rethink the drivers of compensation under trade

The literature on compensation in open economies spans a number of sub-fields in international and comparative political economy. This research is largely divided between those that explore the demand for compensation and those that focus on the supply of compensation. The demand side focuses on what groups of voters are driven to demand compensation and why, while the supply side emphasizes the role of domestic institutions and international constraints in shaping the provision of policy. Although both are necessary to understand compensation, with some exceptions most of the literature has tended to focus on one or the other.

2.1.1 The demand of compensation under trade

The demand side relies on two causal connections to predict which domestic groups demand greater levels of compensation and why. First, international competition is argued to increase economic insecurity through its effect on aggregate volatility (Cameron 1978, Katzenstein 1985, Rodrik 1998). The effect of trade is expected to hold across citizens in an economy, since greater volatility associated with open economies increases levels of risk across the board (Rodrik 1997, Rodrik 1998). This has found some empirical support (Scheve and Slaughter 2001, Walter 2010). As argued by Walter (2010: 407), there is reason to expect individuals facing negative returns from trade to also face higher risks, since these workers are at greater risk of losing their job or receiving lower wages. Scheve and Slaughter (2004) provide evidence of this by looking at foreign direct investment flows. Such arguments are useful to understand how external risk may shape individual welfare, but cannot account for the wide differences

in patterns of compensation across countries (Iversen and Cusack 2000, Huber and Stephens 2001, Adsera and Boix 2002). Iversen and Cusack (2000) argue that for trade openness to increase economic insecurity, either international price volatility must exceed that of domestic markets, or trade must concentrate rather than diversify economic risks. As will be emphasized below, economic geography provides reasons to expect this to be the case.

Related arguments in international trade start from the premise that an individual's support for trade policy is shaped by his or her position in the international economy, although the identity of such winners and losers depends on the assumptions that are made about mobility (Hiscox 2002). Models in the Ricardo – Viner tradition (Jones 1971) assume limited factor mobility and predict that the cleavage between winners and losers of liberalization will run along different economic sectors. Factor endowment models assume factor mobility and argue that an opening of the economy increases demand for and the price of the abundantly available factor of production (Stolper and Samuelson 1941, Findlay and Kierzkowski 1983). Owners of the abundant factor of production benefit from liberalization, whereas owners of the scarce factor are hurt. According to the Heckscher-Ohlin model, trade in OECD countries should reduce demand for unskilled labour (the scarce factor) while increasing demand for skilled labour and capital owners (the abundant factor), driving levels of inequality (Wood 1994). In contrast, in many developing countries where unskilled labour is the abundant factor, changing factor returns will lead to decreased levels of inequality within a country, as returns to the unskilled rise and returns to both skilled individuals and capital

owners decline (Winters 2002, Wood 1994). Support for these predictions has been mixed (Wood 1994, Goldberg and Pavcnik 2004).¹⁶

Second, individuals exposed to increased insecurity and/or negative returns from trade are then argued to demand greater levels of social protection.¹⁷ Arguments based on risk draw on the notion that social policy provides insurance for risks that are not covered by private insurance markets (Varian 1980, Iversen and Soskice 2001, Moene and Wallerstein 2001, Beramendi 2012). Prominent arguments in comparative political economy claim that firm or industry-specific skills constrain worker mobility across firms or industries, and that this drives demand for insurance (Hall and Soskice 2001, Iversen and Soskice 2001, Cusack et al. 2006, Rehm 2009). According to these authors, individuals who have made risky investments in specific skills should demand insurance against potential loss of income in the future. Echoing this logic, recent research explores the connection between international competition and demand for social protection. On a macro-level, Rickard (2006) argues and finds that skill specificity conditions the relationship between trade and social security and welfare spending.¹⁸ On a micro-level, however, Rehm (2009) finds little evidence that individuals employed in tradable sectors or in industries with a comparative disadvantage prefer increased levels of redistribution.

¹⁶ Research in development economics shows that the income gains to the unskilled (abundant) factor in many developing countries undergoing liberalization have not translated into less inequality (Wood 1994, Goldberg and Pavcnik 2004).

¹⁷ Such insights have been echoed by a large literature exploring the determinants of trade policy preferences (Scheve and Slaughter 2001, Mayda and Rodrik 2005, Hays, Ehrlich and Peinhardt 2005, Hays 2009). Mayda and Rodrik (2005) find evidence consistent with the specific-factors model, while Scheve and Slaughter (2001) find evidence in support of the factor endowments model. Hays (2009) argues and finds that those employed in industries with a comparative advantage are also more likely to support liberalization.

¹⁸ Relatedly, Jensen (2011) finds that coordinated market economies are more likely to channel demand for social protection, as employers dependent on a labour force with specific skills are supportive of extensive social spending to protect such skills.

With few exceptions, however, extant research has paid relatively less attention to the geographical dimension of individual risk, or the extent to which contextual characteristics may shape mobility across sectors in the event of job loss (but see Beramendi 2012, Barber 2014).¹⁹ Workers employed in industries facing foreign competition are more or less dependent on environmental factors for reemployment in the event of a shock. All else equal, workers adversely affected by an external shock in a competitive region with a diversified industry will have greater outside options than workers in economically specialized regions that are reliant on a few sectors. Existing research on the determinants of fiscal policy suggests that regional context matters for individual patterns of support for redistribution (Beramendi 2012, Rueda and Stegmüller 2014). Echoing arguments about risk, Rickard (2009) emphasizes the role of mobility in shaping demand for “narrow” transfers such as industry subsidies and trade protection. Rickard (2009) argues that individuals that face high adjustment costs (and are thus less mobile) prefer narrow transfers, while such transfers are less attractive to mobile workers who are less tied to the fortunes of a particular industry. In turn, Mansfield and Mutz (2009) find that individual attitudes towards trade are driven by perceptions on whether trade harms or benefits the economy as a whole. That individuals appear to care about their surrounding area when forming preferences about trade suggests that factors other than industry of employment matter. Specifically, it suggests that there may be features linked to the regional economic environment that condition support for compensation.

Arguments based on the distributional effects of openness expect trade to shape demand for compensation through two mechanisms. A first mechanism posits that trade should

¹⁹ One important exception is Beramendi (2012), who explores how regional specialization increases risk and drives redistributive demands. The argument in this research looks at the joint role of specialisation and competitiveness.

increase demand for redistribution through its effect on inequality (Boix 2011, Meltzer and Richard 1981, Milanovic 2000). In developed economies, where trade reduces demand for unskilled labour (scarce factor) and increases that for skilled labour and capital owners, growing inequality resulting from changes in factor returns should be associated with greater demand for redistributive policies (Boix 2006, Boix 2011). In developing countries where unskilled labour is the abundant factor, decreased inequality should lead to lesser demand for compensation. A second mechanism posits that owners of the abundant factor benefit from stronger bargaining power due to changes in factor returns (Rogowski 1989, Alt et al. 1996, Hiscox 2002, Wibbels and Ahlquist 2012). In developing economies, the greater bargaining power of unskilled labour should translate into greater compensation (Rudra 2002).

Arguments based on models of international trade have provided persuasive accounts of trade politics across developed and developing countries (Milner 1988, Hiscox 2002).²⁰ However, they travel less well from one setting to another (Alt et al. 1996), and do not explain well why trade losers in some countries demand less compensation than in others. Arguably, such models make strong assumptions about individual utility and overlook important sources of individual heterogeneity. Recent research emphasises the role of other-regarding preferences in individual support for trade protection, in the form of inequity aversion (Lu, Scheve and Slaughter 2012). Other scholars find that individual attitudes towards trade are driven by perceptions on whether trade harms or benefits the economy as a whole (Mansfield and Mutz 2009), while yet others argue demand for trade protection is contingent on service workers in economically specialised regions who demand subsidies for prominent industries in decline (Barber 2014). This has been paralleled by a growing body of research on market reform in

²⁰ Alt et al. (1996) offer a good review.

developing countries that highlights several dimensions underpinning demand for trade liberalisation and social spending. Scholars emphasise the importance of consumer motivations in driving mass levels of support for trade (Baker 2010), the role of firm heterogeneity in offsetting adjustment costs (Kingstone 1998, 2001, Kosacoff 2000), or the role of economic context in shaping preferences for policies that enhance competitiveness at the expense of demand for social security (Wibbels 2006, Mares 2005).²¹

The above discussion suggests two things. First, contextual factors are likely to shape the formation of preferences for compensation in response to trade. Secondly, relatively little is known about how contextual differences shape individual preferences for compensation in open economies. With some exceptions, the particular features of regional economies that shape levels of risk among trade losers remain underspecified.

2.1.2 The supply of compensation

Supply side arguments revolve around features that constrain or facilitate the provision of policy. Prominent arguments in international political economy emphasise the difficulty of providing social protection in a context of increased interdependence (Rodrik 1997, Steinmo 1994). Many scholars in this literature argue that even if it increases demand for compensation, increased openness generates pressures that constrain governments' ability to supply it. A first argument emphasizes the adverse effect of increased compensation on levels of competitiveness. Higher levels of social spending may lead to higher tax burdens and increased regulation, as well as greater labour market rigidities and lesser cooperative behaviour from organized labour (Steinmo 1994, Kurzer 1993), all of which increase the costs of labour and reduce the

²¹ To the extent that workers in trade-exposed sectors benefit from social security, however, it is not clear that all workers in exposed sectors will demand cuts to social security.

competitiveness of a country's products. In addition, mobile capital can avoid paying higher taxes levied to fund more generous social spending by moving to a different country. Lastly, capital and trade openness erode fiscal and monetary autonomy to directly address the risks of openness and to underwrite welfare spending (Oatley 1999). Such constraints have been argued to apply to a greater extent in the developing world, whose structural dependency on international capital severely limits its ability to borrow in order to increase social spending countercyclically (Wibbels 2006). Taken together, such arguments imply that increased trade will result in lower levels of compensation. The evidence for this claim has found some support for developing (Wibbels 2006, Kaufman and Segura-Ubiergo 2001) and developed economies (Rodrik 1997, Down 2007, Busemeyer 2009).²² Yet such arguments cannot explain variation in levels of welfare spending observed across and within developed and developing economies. If governments are so constrained in the provision of policy, what explains the wide differences in the level and composition of welfare spending across developed (Garrett 1998) and developing countries (Etchemendy 2011, Rickard 2012a)?

Partly in response to this, prominent arguments in comparative political economy emphasise the role of political-institutional conditions mediating the effect of openness on domestic spending outcomes. Studies have emphasized the role of corporatist institutions, partisanship, regime type, veto players and electoral institutions (Garrett 1998, Boix 1998, Adsera and Boix 2002, Ha 2008, Swank 1998, Hays 2009). Important arguments in developed and developing countries attribute variation in spending outcomes under trade to differences in corporatist institutions (Garrett 1998, Rudra 2002, Rudra 2005). Garrett and co-authors find that countries combining left government and encompassing unions (union density and centralization) generally

²² Rodrik (1997) and Busemeyer (2009) focus on public spending.

provide greater welfare spending and facilitate wage moderation that mitigates capital flight and macroeconomic punishment, while Burgoon (2001) finds that encompassing unions increase compensation that addresses labour market risks. This has been echoed in the literature on industrial policy, which argues that larger and spatially concentrated industries find it easier to mobilise to secure protection (Grossman and Helpman 1994, Busch and Reinhardt 1999, McGillivray 2004). Such research has produced valuable insights, but with some exceptions, tends to assume that losing interests uniformly demand increased welfare spending or trade protection.²³ Yet other studies explore the role of electoral systems. Hays (2009) argues that globalization creates distinct pressures on governments in liberal market economies, where trade shocks are directly passed on to workers in terms of employment levels. Because majoritarian democracies are more dependent on capital taxation than consensual ones, governments in these countries are likely to be more exposed to the constraints imposed by international capital mobility and thus less able to provide spending.²⁴ Together, these studies suggest that political institutions mediate the effect of trade openness on levels of social spending. However, the differential effect of trade on demand *within* countries remains largely unspecified.

Arguably, the literature on compensation in developing countries is beset by similar problems. Building on factor endowments models, Rudra (2002, 2005) finds that the weak bargaining position of low-skilled labour in developing countries translates into low levels of social welfare spending. While intuitive, such studies rely on the assumption that most low-skilled workers prefer greater levels of spending on social

²³ For instance, McGillivray (2004: 23) acknowledges that the “theoretical focus [of her research] is how governments supply protection, not how industries demand protection”.

²⁴ A third argument focuses on the “policy feedback” endogenous to the development of national welfare programmes that diffuse any strong connection between openness and welfare. The main insight is that whatever the dislocation caused by openness, the political demand and supply of welfare benefits is more heavily influenced by country-specific partisan changes, institutional constraints, and “policy feedback” endogenous to the development of welfare programs (Pierson 2001). Here welfare politics is mostly about domestic struggles tied to the historical development of a country's welfare, not globalization.

welfare. Yet as discussed earlier, there is reason to expect variation in individual support for free trade and different aspects of social welfare spending (Kingstone 2001, Baker 2010, Wibbels 2006). In turn, a large literature on market reform highlights the complicated bargains that governments engage in to offset popular opposition to reform.²⁵ These studies focus on the provision of side-payments to craft coalitions for market reform in the presence of strong opposition (Murillo 2001, Etchemendy 2001, 2011, Teichman 2001, Corrales 1998, Treisman 2003). Scholars have emphasized numerous aspects underpinning such political coalitions, ranging from partisan (Levistky 2003, Corrales 2002) to sectoral (Murillo 2001, Etchemendy 2004, 2011) and territorial factors (Gibson 1997, Kurtz 2004, Wibbels 2005). However, lacking in these accounts is an understanding of why not all groups affected by liberalization were equally hostile to reform.

In particular, arguments based on sectoral cleavages in developing countries arguably lead to a focus on policymaking in the lower house. In many Latin American countries, for example, groups such as organised labour enjoy privileged access to deputies in the lower house, who in many cases are union members running on party lists (Etchemendy 2011). Given the connection between interest groups and lower house representatives, such arguments have led to a focus on legislative bargaining in the lower house.

However, to the extent that many Latin American countries are also bicameral, such studies overlook the role that representative institutions that cater to territorial interests may play in shaping policy. This makes it difficult to distinguish between the role of preferences, of legislative institutions and that of electoral concerns.

²⁵ Early studies of market reform focused largely on the conditions facilitating reform. These studies largely assumed that reforms were public goods that generated collective action problems, which could be addressed by a strong executive (Geddes 1994, Haggard and Kaufman 1995, Bates et al. 1992) or by elites with incentives – largely generated by economic crisis – to launch unpopular reforms (Stokes 2001, Weyland 2002).

A growing literature in international political economy provides good reasons to expect political institutions to interact with underlying preferences in the supply of compensation. Building on arguments in comparative political economy, research on trade protection argues that electoral rules shape political incentives to target protection to particular constituents (Rickard 2009, Rickard 2012b, Barber 2014, McGillivray 2004).²⁶ Rickard (2012b) finds that majoritarian rules lead politicians to provide more “narrow” transfers than PR when its beneficiaries are geographically concentrated. Because the benefits of subsidies are concentrated in a given district and the costs are spread across taxpayers, “subsidies are... an efficient way for incumbent politicians to maximize their chances of re-election in plurality systems when voters with an economic interest in subsidies are geographically concentrated” (Rickard 2012b: 860). In contrast, policymakers in systems governed by PR will be more responsive to narrow interests when the latter are geographically dispersed (Rickard 2012b: 861). Barber (2014) complements these insights by arguing that demand for protection in specialized regions is driven by the presence of service sector workers, who support subsidies for manufacturing workers on whose welfare service workers are dependent. Such studies provide key insights: regional differences are likely to empower groups of voters with a preference for protection, but this effect is likely to vary across electoral systems. They echo research in comparative political economy exploring the conditions under which electoral rules are likely to matter more or less in the supply of policy (Rodden 2010, Beramendi 2012, Wibbels 2005).

²⁶ These studies build on a prominent literature that attributes variation in levels of protection to differences in electoral rules (Rogowski 1987, Rogowski and Kayser 2002, Chang et al. 2008, Mansfield and Busch 1995). On the one hand, studies find that PR leads to more industrial subsidies and tariffs due to the greater electoral losses associated with straying from median voter preferences for “broad” transfers in majoritarian systems (Rogowski and Kayser 2002, Chang et al. 2008, Rickard 2009). On the other, scholars find that majoritarian rules lead to greater protection (Mansfield and Busch 1995).

The factors that drive policymakers to provide compensation in given geographical and institutional settings, however, are likely different from those that induce them to provide trade protection. To the extent that compensation policies such as unemployment benefits and active labour market policies are largely concerned with reemployment, contextual factors such as regional economic structure are likely to play a significant role – and as outlined next, in ways that differ from existing explanations. In addition, a theoretical literature in comparative political economy suggests that the effects of electoral rules are likely to be dampened in the presence of a second chamber (Cameron and McCarty 2004). To the extent that upper chambers represent regional interests, the politics of compensation are likely to play out differently relative to unicameral systems.

With this in mind, the sections that follow build on these insights to argue that compensation under trade is better understood as the joint outcome of demand factors stemming from regional characteristics and supply factors resulting from a set of institutional arrangements.

2.2 Regional specialization, competitiveness and preferences for compensation

2.2.1 Defining compensation

Compensation can take many dimensions. In this research, compensation refers to the provision of social policy that directly addresses the risk of income loss: unemployment benefits and active labour market policies. While broadly redistributive, welfare spending comprises policy items that address risks such as old age, sickness or disability, which may or may not be (directly) related to changes in the structure of the economy. Unemployment benefits are transfers in cash designed to offset the costs of income loss, and can be earnings-related and assistance-based. Earnings-related benefits

are linked to prior contributions and compensate for lost salaries, while assistance benefits are generally linked to minimum wages and provide subsistence benefits. Active labour market policies comprise policies aimed to improve an individual's chances of finding employment, and include public employment services and administration, employment subsidies, job rotation schemes, start-up incentives, direct job creation and labour market training, as well as support for the disabled. These two policy measures are thus ideally suited to capture demand for and supply of policies addressing income loss.

2.2.2 Defining winners and losers

Who wins and who loses from trade in an open economy? The starting point of the analysis is that current income from trade and the risk of income loss in the event of a shock shape the extent to which individuals win or lose from trade in an open economy.²⁷ While individual exposure to trade shapes current income from trade, regional specialization and competitiveness jointly shape the risk of income loss faced by an individual.²⁸ Current income and risk thus shape individuals' expected income. Although risk may have many dimensions, the focus in this research is on income loss. In line with previous studies, risk is assumed to stem mainly from volatile employment and/or wages (Scheve and Slaughter 2004).²⁹ Drawing on the literature on social insurance, the assumption is that future income is to some degree uncertain and that individuals are risk averse. Because of this, individuals are willing to insure themselves

²⁷ Liberalization has many economic effects: it can affect factor mobility (Boix 2011) or productivity growth rates (Redding 1999), among others. I focus on two distinct effects that have often been conflated.

²⁸ This is consistent with accounts emphasizing that liberalization shapes volatility of labour market outcomes. A large body of evidence documents that labour-market volatility has been rising in many countries, especially in the 1990s, in terms of greater earnings volatility, declining job tenure, and self-reports.

²⁹ Following Scheve and Slaughter (2004), the implicit assumption is that for most people economic risk depends on purchasing power, which in turn depends on both asset ownership and labour market status – both employment and income earned. However, because it is plausible to assume that the majority of people rely to a greater extent on income from labour than capital for purchasing power, labour-market status is taken to be the main source of economic risk (Scheve and Slaughter 2004).

against risks – such as income loss – that are difficult to insure privately (Moene and Wallerstein 2001).³⁰ This implies that risk-averse individuals are not indifferent between employment options that produce the same amount of expected income but with different degrees of certainty. More certain outcomes are preferred to more uncertain ones, and such uncertainty drives demand for compensation. Simply put, workers employed in losing industries who face high risk of income loss support higher levels of compensation than those facing lower risk.

Trade liberalization shapes individual income through its effect on relative prices. Depending on the assumptions made on the extent of factor mobility, standard international trade theory argues that price changes affect the returns of individuals because they affect the incentives to produce particular goods and the technologies they use. Factor endowments models assume factor mobility and focus on the effect of economic openness on relative wages (Stolper and Samuelson 1941).³¹ These models argue that a country's comparative advantage lies in those goods and services predominantly produced with the factors of production with which the country is abundantly endowed. Openness increases the demand for and the price of the abundantly available factor of production.³² Consequently, owners of abundant factors of production benefit from openness, whereas owners of scarce factors lose from openness (Rogowski 1989).

In Ricardo-Viner or “specific factors” models, one or more factors are assumed to be completely immobile between (specific to) industries, and returns to factors of

³⁰ Social protection thus has an insurance aspect in addition to a redistributive one (Moene and Wallerstein 2001).

³¹ Such models also assume that factor supplies are exogenously fixed, wages are perfectly flexible and goods are homogeneous.

³² Where factors are mobile, a change in the price of a product – an increase, for instance, stemming from a change in trade flows or trade policy – would *more than proportionally* increase the return to the factor that is used intensively in the production of that good (Stolper & Samuelson 1941). Thus real incomes of owners of the factor used intensively will rise absolutely, generating incentives to induce that change in prices.

production are tied closely to the fortunes of the industries in which they are employed (Alt and Gilligan 1996). Factors that are specific to export industries receive increases in real wages due to trade, while those employed in industries that are import-competing lose in real terms.³³ As argued by Hiscox (2002), however, given varying levels of factor mobility, liberalization generates losers either along factor lines (where factor mobility is high) or along industry lines (where mobility is low).³⁴ Both models, however, predict that some citizens stand to lose from greater competition to a greater extent than others. Increased international competition with low-cost imports leads to real income losses for such individuals.

The present argument departs from Hiscox (2002) and posits that both exposure to international competition and regional economic structure determine how trade openness affects an individual's wellbeing. Consistent with standard trade arguments, the former shapes the level of income across individuals. In addition, since these workers are at greater risk of losing their job or receiving lower wages, they are also likely to face higher risk. Whether factor- or sector-based, workers employed in uncompetitive (competitive) sectors should face greater (lower) risk on average and support comparatively lower (higher) levels of compensation. Regional specialization and competitiveness, however, may further drive levels of uncertainty associated with the level of income. This is plausible if uncertainty in income streams is conceived of as the ease with which workers are able to find a job in the event of a shock. Within losing sectors, individuals may face higher or lower levels of risk, such that exposure to global competition may be harmful to some people but not others. Thus, while industry of

³³ An important variant of the sectoral approach classifies winners and losers according to their exposure to international competition. This variant emphasizes the difference between the exposed tradable and the sheltered non-tradable sectors (Hays et al. 2005, Hays 2009). Recent research in trade theory also distinguishes between tradable and non-tradable industries, and points to heterogenous distributional effects of trade within the tradable sector (Melitz 2003, Helpman, Itskhoki, and Redding 2008).

³⁴ Walter (2010) provides a more nuanced conceptualization of winners and losers that draws on industry of employment and skill level.

employment matters, particular features of the regional environment may drive the preferences of individuals *within* the same industry apart.

An example may serve to illustrate. For those employed in uncompetitive sectors, trade liberalization translates into lower income, which increase the likelihood of support for compensation. Since the extent of income loss depends on the variability of returns, in the best of cases workers will lose their job and be re-employed in a competitive sector (or retain their job in return for lower income). In the worst case, they may be unemployed. In this case, demand for compensation will be greater. The following develops the claim that regional specialization and *regional* competitiveness jointly determine uncertainty in income streams, and through it demand for compensation.

In this framework, demand for compensation as insurance stems from those workers employed in uncompetitive industries at risk of losing their job. Individuals that win from trade face little or no risk of income loss associated with openness, and are thus opposed to spending on compensation. Arguably, demand for insurance rises with income, and this depends on the degree of risk aversion (Moene and Wallerstein 2001). Whether individuals in winning industries support more or less spending on insurance than those in uncompetitive industries is likely to depend on their relative risk and relative wage (Moene and Wallerstein 2001).³⁵ The argument that trade openness leads to less support for social insurance among those in competitive industries is contingent on holding constant the distribution of the risk of income loss.

³⁵ Iversen and Soskice (2001) find that support for welfare expenditure declines as survey respondents' income increases, controlling for the specificity of skills, while Rehm (2009) finds that support for redistribution increases with occupational risk, controlling for income.

2.2.3 Why regional specialization and competitiveness matter

Geography provides a number of reasons to expect regional economic differences to drive patterns of support for compensation. Economic geographers distinguish between specialized and diversified regions, where regional economic specialization refers to a region's reliance, in economic terms, on a reduced number of related sectors. Both specialized and diversified regions are instances of industrial agglomeration. In the former, localization or Marshallian economies stemming from thick and specialized labour markets, local access to specialized suppliers and knowledge spillovers induce industries to cluster together (Marshall 1920, Krugman 1991, Puga 2010, Overman and Puga 2010). In the latter, externalities arising from a diversified regional structure, known as Jacobs' externalities, trigger new ideas and induce knowledge spillovers, generating incentives for firms to be near firms in a large variety of sectors (Jacobs 1969, Glaeser et al. 1992, Fujita, Krugman and Venables 2001, Martin and Ottaviano 1999). While both specialized and diversified regions have long-term positive effects on innovation and growth, they differ on their effect on mobility. In specialized regions, mobility between sectors may be expected to be lower.

Regional specialization contributes to regional growth through its effect on long-term productivity gains. Research shows that firms located in less specialized regions are usually less productive than similar firms in more specialized regions (Combes and Duranton 2001, Henderson and Thisse 2004). Localization economies tend to spur incremental and process innovation, as the spillovers originate from firms producing similar products. This translates into productivity increases (Frenken et al. 2007).³⁶

Moreover, research has shown that regional specialization mostly involves the

³⁶ The benefits of such spillovers are likely to be greater among industries that rely on standardized production, such as traditional manufacturing industries (Henderson 1988, Henderson et al. 1995, Henderson 2003, Martin and Ottaviano 1999).

agglomeration or concentration of standard manufacturing industries, such as textiles, food, automobiles and basic industries, traditionally the more exposed sectors in any economy (Henderson 2003, Henderson et al. 2005, Martin and Ottaviano 1999).³⁷ In contrast, Jacobs' externalities generally facilitate product innovation, as knowledge and technologies from different sectors are recombined and lead to new products or technologies. This leads to increases in employment growth (Frenken et al. 2007).

However, regional specialization may limit mobility in a number of ways. A first – mechanical – effect stems from endogenous agglomeration among industries. Localized externalities imply that firms prefer to be near large agglomerations of other firms in their own industry or related industries. Because of this, they tend to occur when a region is specialized in a few related sectors (Hanson 2001).³⁸ The limited number of sectors reduces outside options available to workers. In addition, and akin to corporate diversification in product portfolios, regional diversification protects regional income from sudden sector-specific shocks in demand (Van Oort 2004, Frenken et al. 2007). In a diversified region with very different types of activities, a negative shock in demand for any of these sectors will have mild negative effects on growth and employment, protecting labour markets and preventing unemployment. In contrast, a specialized regional economy that is reliant on a few sectors may be vulnerable to the risk of regional downturn (Frenken et al. 2007).³⁹

There are other reasons to expect diversified regions to foster mobility to a greater extent than specialized regions. While the literature on industrial organization has traditionally

³⁷ Kolko (1999) shows that those manufacturing industries thriving on product innovation (such as high-fashion apparel and publishing manufactures) and most services (such as financial, business, research and development and management services) tend to be found disproportionately in larger, diversified areas.

³⁸ In contrast, Jacobs' externalities arise from a diversified regional structure, which triggers new ideas and induces knowledge spillovers. Such externalities generate incentives for firms to be near firms in a large variety of sectors, and tend to occur in diversified regions (Jacobs 1969, Glaeser et al. 1992, Fujita, Krugman and Venables 2001, Martin and Ottaviano 1999).

³⁹ Under the (plausible) assumption that firms in related industries are likely to have partially correlated demand.

emphasized that large firms are more likely to innovate, recent research highlights reasons to expect small firms to have an advantage.⁴⁰ Small and medium enterprises (SME) may be faster at recognizing opportunities, and more flexible in adjusting research plans or implementing them (Tether 1998). SMEs have also been found to take advantage of regional knowledge networks to a greater extent (Almeida and Kogut 1997, Love and Roper 1999, Rogers 2004).⁴¹ Larger firms' investment decisions are more likely to be influenced by corporate strategy, or are more likely to serve a national market, so changes in regional demand may have less effect on its output and thus investment decisions (Kelley and Helper 1999). Lastly, research shows that agglomeration economies from diversification are stronger and particularly advantageous for smaller firms: SMEs have been shown to benefit from knowledge spillovers in diversified regions – not so in specialized regions – and to innovate more as a result (Kelley and Helper 1999). Together, this suggests that the presence of a thick fabric of SMEs in diversified regions increases the capacity to innovate.

Finally, specialized regions tend to be marked by greater levels of skill specificity, which further increases demand for compensation. This echoes arguments in comparative political economy that argue that firm or industry-specific skills constrain worker mobility across firms or industries (Hall and Soskice 2001, Iversen and Soskice 2001) and that this drives demand for insurance (Cusack et al. 2006, Rehm 2009). The implication of this argument would be that demand for compensation increases in

⁴⁰ Early arguments claimed that liquidity constraints increased the costs investment for firms with smaller revenue streams, and that the costs of employing specialists to increase the probability of successful implementation of a new technology is lower for larger firms who can spread fixed costs over more output (Cohen and Levin 1989).

⁴¹ Research on Italian regions shows that innovation (as patent output) depends on the level of research and development in the region and the level of university research, and that SMEs benefit more from such research than large firms (Audretsch and Viverelli 1994). Similar patterns have been found in US regions (Almeida and Kogut 1997). Knowledge networks are broadly referred to in this literature as webs of relationships between organisations through which knowledge flows, and is consistent with the association between diversification and knowledge spillovers. Love and Roper (1999) and Rogers (2004) find that small manufacturing firms exhibit a positive association between knowledge networks and innovation.

diversified regions as well if skills are firm specific. However, evidence shows that shared technologies in manufacturing industries allow workers to transfer across industries, and thus that generic skills are maintained in regions with different sectors (Döringer and Terkla 1995).⁴² The argument thus relies on the assumption that workers may have different components to their skill set, which may be more or less valued depending on regional characteristics. In a region specializing in a group of similar sectors, workers may require industry-specific qualifications plus on the job training. Re-employment in a firm where firm-specific skills are not valued may imply some income loss, but industry-specific skills are retained, and income loss is mitigated. In a region marked by the presence of very different sectors, industry or firm-specific skills may reduce mobility, but some general skills are retained that allow workers to move. In this framework, firm-specific skills do not play a central role. Together, this suggests that regional specialization reduces outside options and drives demand for compensation in the event of a shock.

Given this, the argument underlying the analysis is that it is the *interaction* of regional specialization and regional competitiveness, or the export performance of regions, that shapes preferences for compensation among those that lose from trade. Regions may be more or less reliant on competitive sectors. Those regions with a greater share of employment or production in competitive sectors are able to benefit from positive externalities. Where specialized, competitive regions benefit from gains in productivity stemming from specialization; if diversified, competitive regions are likely to benefit

⁴² Döringer and Terkla (1995: 231) provide a good description of this logic: “The industry specificity of such indigenous skills... should not be construed too narrowly. In our study of mature industries in central Massachusetts, for example, a major location factor was a set of generic skills connected with the ability to form materials with precision. These generic skills were used in a range of product lines and technologies: precision molding of plastics, precision metalworking and fabrication and precision woodworking. They seemed transferable across industries and attracted firms whose competitive advantage derived from the ability to manufacture precision products for specialized markets. Transferability of labour opens opportunities for dynamic efficiency through cross-fertilization of skills and techniques.”

from Jacobs' externalities. But to the extent that there is some uncertainty about the level of regional competitiveness in the future, more specialization implies greater vulnerability to a possible decrease in regional competitiveness. In contrast, uncompetitive regions are unlikely to benefit from such externalities.⁴³ This has implications for those that stand to lose from trade.

Take, for instance, losing individuals in uncompetitive and specialized regions. In expectation, those employed in industries that lose from trade and are also at greater risk of losing their job. In the event of a shock, limited outside options together with correlated demand between sectors constrain mobility between sectors. Moreover, low regional competitiveness constrains the capacity of employers to absorb labour *despite* the presence of positive externalities. Those employed in losing industries in specialized and uncompetitive regions thus have incentives to support high compensation. Those employed in losing industries in diversified and uncompetitive regions face lower levels of uncertainty. Low competitiveness limits positive externalities and constrains reemployment across sectors. But a diversified industrial base increases outside options in the event of a shock, both because of the higher number of alternative sectors to move to and the lower likelihood of downturn in the event of a sector-specific shock. Relative to those in specialized uncompetitive regions, therefore, losing individuals in diversified and uncompetitive regions should support lower levels of compensation.

In turn, individuals in losing industries in diversified competitive regions are expected to demand relatively low levels of compensation. Losing individuals in diversified and

⁴³ A second mechanism also revolves around the capacity of exposed sectors to innovate. Sectors that are the most open to international competition are also most likely to contribute to innovation and economic growth (Fagerberg and Verspagen 2000, Boschma and Iammarino 2009). In particular, exporting sectors in a province are those that give rise to outflows of knowledge from a region and also those that better absorb, adapt and recombine new inflows of knowledge into the region (Boschma and Iammarino 2009). However, the argument does not explicitly address this mechanism.

competitive regions benefit from the employment effects of diversification. Although there is some uncertainty about regional competitiveness, a diversified industry increases outside options and thus significantly dampens levels of support for compensation. The two combine to dampen any (positive) effect of trade on support for compensation among individuals in losing industries. In specialized competitive regions, positive externalities and high competitiveness dampen labour market risk. But specialization implies greater vulnerability to a possible decrease in regional competitiveness, leading individuals to demand some level of compensation. These individuals should experience tensions between the gains of competitiveness and the costs of specialisation. Specifying when one will prevail over the other is beyond the scope of this research, though factors such as price volatility or the degree of exposure may plausibly affect the relative importance of either. The argument thus does not generate unambiguous predictions for individuals in specialized and competitive regions. Rather, there should be greater variability in support for compensation.

Table 2.1. Preferences over level of compensation among individuals employed in losing industries, by regional specialization and competitiveness

Regional Competitiveness	Regional specialization	
	Low	High
Low	Medium	High
High	Low	Low/Medium

In sum, the positive effect of trade on demand for compensation should be more pronounced among those employed in losing industries in specialized and uncompetitive regions than among similar individuals in diversified regions. In turn, the positive effect of trade on demand should be significantly dampened among those employed in losing

industries in competitive and diversified regions. Table 2.1 summarizes these predictions.

2.3 Institutions and the supply of compensation

What shapes the extent to which preferences are aggregated into policy outcomes?

Institutions differ on the extent to which they provide incentives for politicians to target particular districts or broader national interests. Building on arguments in political economy and comparative politics, the argument first distinguishes between electoral systems that cater to geographically defined interests and those that target more general interests. It argues that the effect of electoral institutions on policy is contingent on the underlying structure of demand for compensation. It then extends the argument to the role of federal institutions in driving policy outcomes.

2.3.1 How electoral rules interact with preferences over compensation

A large literature in comparative politics has explored the role of electoral institutions on interest representation (Lijphart 1984, Powell and Vanberg 2000, Rae 1971, 1995, Taagepera and Shugart 1989). Related to this, a growing literature in comparative political economy has emphasized the role of electoral institutions in shaping the level and composition of public spending (Persson and Tabellini 2000, Persson and Tabellini 2003, Lizzeri and Persico 2001, Milesi-Ferretti et al. 2002, Iversen and Soskice 2006, Rodden 2010, Breunig and Busemeyer 2012). These studies take as their starting point the observation that countries with proportional representation have greater welfare states and redistribute more than those with majoritarian rules.

The predominant theoretical framework for understanding how electoral institutions shape policy outcomes draws on models of economics to model government policy-making as a delegation game, where policymakers are agents and voters are principals

(Persson and Tabellini 2000). Politicians care about winning office, while voters are motivated to secure greater benefits from government policy (Persson and Tabellini 2000, Lizzeri and Persico 2001). Winning office requires different distributions of goods and services depending on how policymakers are elected. In their widely cited textbook, Persson and Tabellini (2000) formalize the argument that policymakers elected under majoritarian rules and small districts have incentives to pursue policies that provide benefits to geographically concentrated groups.⁴⁴ District magnitude determines the number of legislators obtaining a seat in a given electoral district. In one extreme case, all legislators are elected in districts with a single seat, while in another legislators are elected in a single, nationwide district. The electoral formula determines how votes are translated into seats. Under plurality rule, those who win the highest vote shares obtain seats in a given district, while under PR seats are awarded in proportion to the total vote share. Empirically, however, most of these features tend to cluster together (Persson and Tabellini 2003).

In systems with low district magnitude and plurality, parties need only obtain a plurality of votes in half the districts plus one to win the election. This provides incentives to target particular benefits to pivotal, or marginal, districts (McGillivray 2004, Rogowski 1997). Under proportional representation, politicians have incentives to favour broad programmes that benefit dispersed interests. In systems with high district magnitude and proportional rules (in the ideal case, one national district), elections are won on the basis of the national vote share, and policymakers have less need to take into account the interests of particular districts. Rather, they take into account the welfare of the entire electorate in order to maximize their chances of winning. This provides them with

⁴⁴ Other prominent arguments posit different causal mechanisms. Iversen and Soskice (2006) emphasize that electoral rules influence redistribution by shaping the partisan coalitions that are likely to win elections.

incentives to propose and implement policies, like broad social programmes, that are national in scope. This theoretical result holds both in prospective models founded on competition between parties before an election or in retrospective models where incumbent parties decide or implement policy in order to be reelected (Persson and Tabellini 2000).

Whether they be making campaign promises or in a position to decide government policy, the key implication is that parties in systems governed under PR will favour spending on broad social programmes to a greater extent than under majoritarian systems. Arguably, however, canonical theoretical models do not tell us precisely which real-world programmes are broad and which are targeted. Because of this, it is important to realise that nominally programmatic social spending with a potentially geographically broad set of beneficiaries may have considerable targeted effects if eligible recipients are geographically concentrated. Thus, arguments that predict that politicians under majoritarian systems spend less on social programmes than under PR systems implicitly assume that the distribution of support for such programmes is evenly distributed across the national territory.⁴⁵

The present argument builds on insights from the literature on political economy (Persson and Tabellini 2000, 2003) and the literature on trade protection (Rickard 2012b) and claims that the geographical concentration of trade losers mediates the effect of electoral institutions on compensation. It does so through its effect on the demand and the supply of policy.

Policymakers under plurality have incentives to formulate policies that target voters in geographically defined districts (Persson and Tabellini 2000). This arguably comprises

⁴⁵ This echoes recent research on the role of the territorial concentration of party support (or party nationalization) on spending strategies (Jurado 2014).

those that lose from trade in specialized regions, competitive and uncompetitive. Trade losers concentrated in uncompetitive regions face very high levels of labour market risk, and demand high levels of compensation. In turn, trade losers concentrated in competitive regions face some level of risk because specialization makes them vulnerable to hypothetical shocks, but they also benefit from high competitiveness. On average, therefore, trade losers in specialized regions across levels of competitiveness should demand relatively high levels of compensation. In the Persson and Tabellini (2000) framework of electoral competition based on probabilistic voting, citizens care about economic policy but also have an ideological bias (or more broadly, a non-policy bias) that shapes their vote choice. Groups of voters with a relatively small ideological bias constitute attractive targets for opportunistic politicians keen to buy voter support by manipulating economic policy. These are the swing voters. Under the assumption that trade losers are swing, a high concentration of trade losers in a few regions will induce policymakers under majoritarian rules to increase compensation. In the presence of such high demanders, therefore, low magnitude systems are likely to translate into higher levels of compensation.⁴⁶ The key assumption is not that trade losers are always swing voters, but that they sometimes are. For example, McGlilivray (2004) provides evidence that losing industries are sometimes found in marginal districts.

Other factors may also increase incentives to cater to concentrated trade losers. The literature on economic geography emphasizes that specialized regions tend to be less densely populated. Industries subject to Jacobs' externalities require a diverse and usually large urban environment, and thus tend to be present in more densely populated areas. Evidence shows that many standardized manufacturing activities such as textiles,

⁴⁶ In addition, losing interests in specialized and uncompetitive regions share a preference for greater compensation, making the provision of policy electorally "efficient" as the benefits of greater spending are concentrated in particular electoral districts and spread across taxpayers (Rickard 2012b: 860).

food processing, steel, car production and wood products tend to be found disproportionately in specialized, underpopulated areas (Black and Henderson 2002).⁴⁷ Given that regions specializing in traditional manufacturing activities tend to benefit disproportionately from localization economies, such regions may also be relatively underpopulated. On average, therefore, underpopulated districts may be expected to be overrepresented in majoritarian systems to a greater extent.⁴⁸ Targeting compensation towards such interests thus increases the electoral gains of spending, as the benefits of policy are likely to be greater among a reduced pool of beneficiaries.

In contrast, policymakers under PR may be expected to have lesser incentives to target losers that are geographically concentrated, competitive or not. Governments in systems with high district magnitude are dependent on the national vote share to win reelection and are thus less likely to focus on geographically defined constituents. Even if concentrated losers in uncompetitive regions demand relatively greater compensation, meeting their demands is unlikely to increase chances of re-election significantly. Catering to trade losers in concentrated districts is likely to come at the expense of dispersed groups of voters. Since policymakers are dependent on support from dispersed losers, doing so may potentially compromise reelection.

The presence of dispersed losers has striking implications for policy in proportional systems. Because elections are won on the basis of the national vote share, politicians competing under PR have incentives to cater to geographically dispersed voters. This comprises trade losers in diversified regions, competitive or uncompetitive. However, when demand for compensation is low, as among trade losers in uncompetitive

⁴⁷ While industries subject to localization economies also benefit from being in bigger, more densely populated areas, the benefits of dense populations are limited by overall local congestion and commuting costs (Mills 1967, Henderson et al. 1995).

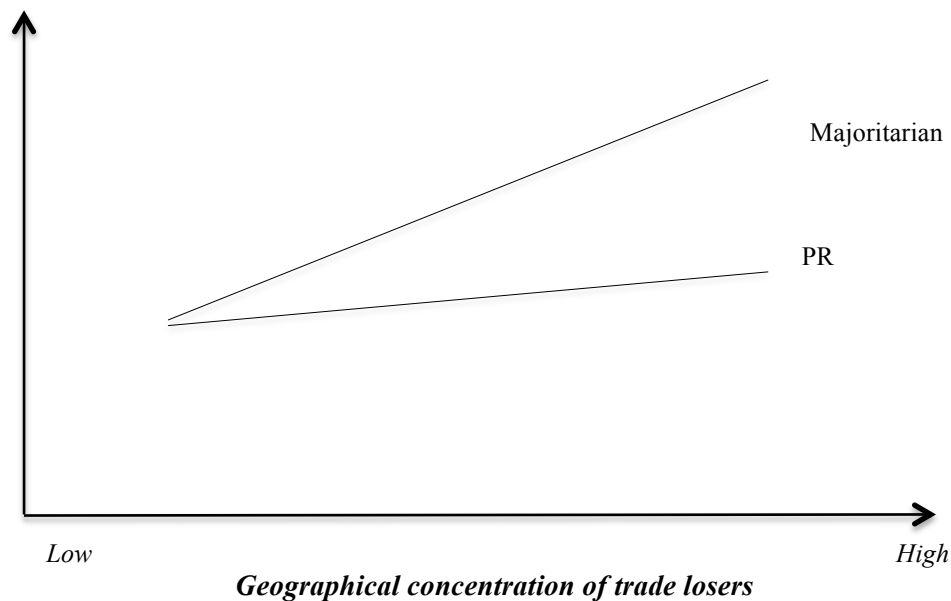
⁴⁸ Majoritarian systems also hold out great potential for electoral overrepresentation (Powell and Vanberg 2000).

diversified regions, even politicians in systems with high district magnitude will have few incentives to increase compensation. Where such trade losers are dispersed, low demand for compensation dampens the supply of compensation by politicians in such systems, who would otherwise be expected to increase spending. (Like above, the very low level of demand for compensation among losing individuals in diversified competitive regions further dampens policy.) This is similar to the expected outcome in majoritarian systems. Where trade losers are geographically dispersed, policymakers under plurality have lesser incentives to increase compensation, as distributing benefits without geographic discrimination will not increase their electoral rewards. The absence of high demanders further dampens incentives to increase policy. This implies that there should be no significant differences in the provision of compensation between governments elected under different rules in contexts where trade losers are geographically dispersed.

To sum up, electoral institutions interact with the geographic distribution of trade losers to shape the level of compensation. When trade losers are geographically concentrated, policymakers elected in low-magnitude and plurality systems cater to the interests of trade losers to a greater extent than under high-magnitude PR systems. When they are geographically dispersed, policymakers in high-magnitude PR systems and low-magnitude plurality systems will exhibit no significant differences in compensation levels, all else equal.

Figure 2.2. Expected relationship between geographical concentration of trade losers, electoral institutions and level of compensation

Compensation



2.3.2 The role of veto players

The above argument emphasizes that by shaping political incentives, electoral institutions strengthen the ability of particular groups to extract compensation. Yet regional groups may also engage in veto bargaining to exert influence on policymakers (Tsebelis 2002, Cameron and McCarty 2004). Veto bargaining is among the most widespread forms of political bargaining, and the ability to veto may stem from features linked to a variety of institutional structures, ranging from the structure of the upper house, that of the lower house, party system or interest groups.⁴⁹ This research focuses on veto bargaining in the upper house. Where territorial interests are formally represented in the national policy making process, interests that stand to lose from trade are likely to engage in political bargaining over the level of compensation. This section

⁴⁹ Examples include an executive presenting the lower house with a proposal, which it may accept or reject, or a political party placing an initiative to be voted on by members. Both may be subject to pressure from regional groups.

thus extends the argument to those cases where regional interests are formally represented in the national policymaking process. It emphasizes that the presence of a strong upper chamber generates institutional veto players with incentives to respond to particular interests, and these may or may not benefit interests that lose from trade. It draws on insights from the literatures on comparative institutions to outline how bicameralism may shape compensation. Note that this framework spans unitary and federal systems, which may have second chambers with legislative powers, but need not do so.

Bicameral systems distinctly incorporate the interests of regions into the national decision-making process. The presence of an upper house generates institutional veto players with incentives to respond to particular interests. There are a number of reasons for this. Firstly, many countries have bicameral legislatures where the upper chamber frequently has legislative veto powers that enable the protection of minority or regional interests in the national policymaking process. A well-established argument in comparative politics claims that for bicameralism to matter, preferences for policy must differ across chambers (Lijphart 1984). The underlying logic is that without a systematic difference between the chamber medians, the pivotal (median) policymaker in the upper chamber will have few incentives to block legislation arising from the lower house, as the electoral base will be the same. This underpinned well-known arguments in the literature in comparative politics that associated bicameralism with compromise (Lijphart 1984) and policy stability (Riker 1992).⁵⁰

Secondly, many bicameral systems are also federal, and federalism generates distinct incentives to cater to specific (regional) interests. Two key aspects distinguish federal from unitary systems. First, regions are formally represented in the national legislative

⁵⁰ The logic has been formalized by Cutrone and McCarty (2006), who show that bicameralism matters only when preferences across chambers are different.

process, and second, the regional level of government has some area of autonomy from the central government (Wibbels 2005). The federalism literature thus defines federalism as a combination of shared-rule through common institutions and regional self-rule for constituent units (Elazar 1992). In practice, the existence of different selection rules across chambers in most federal systems is designed to protect regional interests. Moreover, in many federations this is accompanied by considerable levels of legislative malapportionment. For instance, this is the case in the US Congress, Argentina or Germany. The incentive to veto is exacerbated by the presence of distinct political constituencies in federal countries. A widespread argument in the literature on multilevel accountability states that as the centre plays a larger role in key policy spheres, regional elections will reflect assessments of the national government (Chhibber and Kollman, 2004, Rodden and Wibbels 2010). Where regions play a strong and autonomous role in the national decision-making process, retrospective evaluations of regional politicians for outcomes become increasingly relevant for vote choice. Citizens ascribe high salience to regional institutions, identify the regional administration as responsible for policy outcomes and punish and reward the latter accordingly. This has led some scholars to define federalism as “an institutional arrangement that can create both economic and political incentives for subnational and national officials to conflict over economic policy reforms” (Wibbels 2005: 25). Federal or not, therefore, regional politicians with policymaking power at the national level have strong incentives to steer national legislation in a way that is consistent with their regional interests.

This suggests that the presence of a strong second chamber where regional interests are represented is likely to affect policy outcomes. When is the presence of a second chamber likely to lead to changes in policy? In the absence of a second chamber, the

ideal points of policymakers over compensation translate into policy outcomes.

Consistent with the above argument, the induced ideal point of policymakers under majoritarian systems is expected to be higher than under PR at high levels of demand for compensation. In contrast, ideal points are expected to be relatively similar at low levels of demand.

To understand how bicameralism changes policy outcomes, the argument builds on a simple spatial model in which there are two institutional actors elected under different selection rules, where a proposer makes an offer to the receiver, who may accept it or reject it. This may comprise a lower house that proposes a bill and an upper house that has to sanction it. However, it may also comprise an executive presenting the legislative body (upper or lower house) with a bill, which it may reject or accept. As will be shown in Chapter 6, the latter may be the case in countries where Congress – both upper and lower houses – is strongly defined according to territorial criteria. The current example draws on a lower house (LH) that proposes a bill and an upper house (UH) whose consent is needed to pass legislation. Both lower and upper houses are assumed to be unitary actors, so that there is a pivotal legislator in the lower house (for instance the median member of the chamber, or the party leader) who proposes policy and a pivotal legislator in the upper house who accepts it or rejects it. Both LH and UH bargain over the level of compensation and evaluate policy proposals based on their proximity to their most preferred policies, captured by the symmetric spatial utility functions with the ideal points above. Consistent with many models of redistribution, the status quo is set at zero or very low levels of compensation. The sequence is as follows. The lower house (LH)

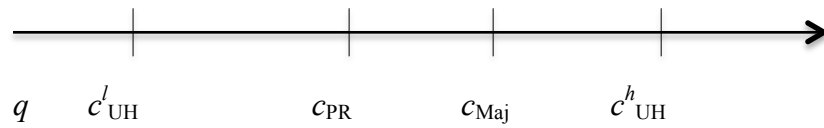
first makes a proposal to change the status quo, q , set at zero compensation. The upper house (UH) must then accept the proposal (which becomes policy) or veto it.⁵¹

Figure 2.3 illustrates the spatial preferences of policymakers in a Lower House elected under PR (c_{PR}) or under majoritarian rules (c_{Maj}) in an economy where demand for compensation is relatively high (because the geographical concentration of losing interests is high). C_{UH} denotes the ideal point of the pivotal legislator in the upper house.⁵² Given that both houses are elected under different rules, pivotal legislators in each chamber may have different ideal points over policy. For instance, legislators in a lower house elected under PR in a country where trade losers are geographically concentrated are likely to favour relatively high compensation (under majoritarian rules, even higher). However, even when average levels of demand are high, pivotal legislators in the upper house may prefer higher or lower levels of spending, depending on the relative size of the pivotal coalition. Given the strong political incentives to represent regional interests, where diversified competitive regions are prevalent or overrepresented in the upper house, the pivotal legislator will cater to regional interests at the expense of the larger electorate, and may prefer low compensation. This is captured by c_{UH}^l . Where specialized (uncompetitive) regions are prevalent, the ideal point of the pivotal legislator will be higher (c_{UH}^h).

⁵¹ Consistent with most analyses of veto power, the game assumes that all actors are perfectly informed about the preferences of all other players. Since there is no uncertainty about how the upper house will respond to a proposal, the lower house chooses optimally given expectations about the future.

⁵² The policy utility functions for LH and UH are $u(x, c_{PR}) = -|x - c_{PR}|$ and $u(x, c_{UH}) = -|x - c_{UH}|$.

Figure 2.3. Spatial preferences for compensation under high demand (geographically concentrated losers)



Thus, at high levels of demand for compensation, two situations may arise. If the upper house is dominated by a coalition of regional interests that prefer relatively low compensation, the pivotal legislator prefers c_{UH}^l . By backward induction, the latter votes to accept the proposal arising from the lower house if it prefers it to the status quo, q . Given that utility functions are symmetric and the status quo, q , is set at zero, the set of proposals that UH accepts is given by $[q, 2c_{UH}^l - q]$, which simplifies to $[0, 2c_{UH}^l]$ because the status quo is set at zero. Thus, as long the proposal made by the lower house is within this set, the upper house accepts and the proposal becomes policy. Given this, the LH proposes $2c_{UH}^l$, as the alternative is zero (q). Note, however, that $2c_{UH}^l$ is substantially lower than the ideal points of either c_{PR} or c_{Maj} .

The above example illustrates two things. First, given high demand for compensation, the presence of a strong upper house dampens levels of policy when the pivotal legislator in the upper house prefers relatively low compensation. In unitary countries, the level of policy is higher regardless of the electoral rule under which legislatures are elected. Secondly, given the presence of a strong upper chamber, electoral rules make less of a difference in terms of policy outcomes. Whether PR or majoritarian, the effect of electoral rules on political incentives is dampened by the presence of a strong veto player in the legislative process.

In contrast, where dominated by regional interests that prefer relatively high compensation, the presence of a strong upper house when demand for policy is high

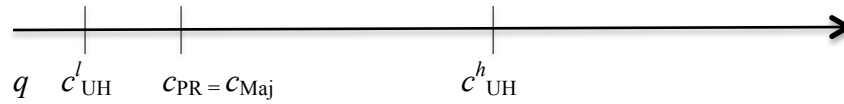
makes less of a difference for policy outcomes. In this situation, the upper house prefers c_{UH}^h . Where the status quo is zero, the upper house accepts any proposal that lies in the range $[q, 2c_{UH}^h - q]$. Given that this set comprises the ideal points of the pivotal legislators in the lower house, legislators in the lower house propose their preferred policy, whether under PR, c_{PR} , or under majoritarian rules, c_{Maj} . Thus, given high demand for compensation, the presence of an upper house that prefers relatively high compensation makes little difference for policy outcomes. In addition, the differences between PR and majoritarian rules are maintained. Specifically, legislators in a lower house elected under majoritarian rules propose greater levels of policy than those elected under PR, and this is accepted by legislators in the upper house. In other words, at high levels of demand, policymakers elected under majoritarian institutions provide greater levels of compensation relative to those elected under proportional rules. This mirrors the mechanism developed in the previous section.

Figure 2.4 illustrates policy preferences when levels of demand for compensation are relatively low, and thus where the geographical concentration of losing interests is relatively low. In this scenario, the ideal point of the pivotal legislator in a lower house elected under PR is not substantially different from that of a legislator elected under majoritarian rules. Consider an upper house dominated by regional interests that prefer low compensation, c_{UH}^l . The upper house accepts the proposal made by the lower house as long as it lies within the set $[q, 2c_{UH}^l - q]$. Given that the alternative is zero compensation (q), LH proposes $2c_{UH}^l$. But this level of policy is lower than that preferred by the lower house – whether elected under PR or under majoritarian rules.⁵³

⁵³ The preferred ideal point of the upper house may also lie somewhat to the left of the lower house, so that the former's acceptance set comprises the latter's ideal point. In this case, the lower house's proposal becomes policy. This does not significantly change overall results.

Thus, the presence of an upper house where the pivotal legislator wants very low levels of compensation leads to low levels of policy, regardless of electoral rules.

Figure 2.4. Spatial preferences for compensation under low demand (geographically dispersed losers)



Lastly, like above, when demand for policy is low, the presence of a strong upper house dominated by regional interests that prefer relatively high compensation makes less of a difference for policy outcomes. Given the distribution of preferences in Figure 2.5, UH accepts any proposal that lies in the range $[q, 2c_{UH}^h - q]$. This comprises the ideal points of the pivotal legislators in the lower house, and thus the lower house proposes its preferred level of policy. The preferred policy of LH, under PR or majoritarian rules, will be similar. Given low demand for compensation, therefore, bicameralism matters less for policy outcomes in the presence of high-demanding regional interests.

Moreover, while they shape policy, the effect of electoral rules implies that policy converges towards low levels of compensation.

The spatial argument has empirical implications within and across countries. Within countries, the presence of a strong upper chamber dampens levels of compensation where regional veto players in the upper house prefer lower levels of policy, and this reductive effect is larger when the level of demand in the economy is higher. At low average levels of demand, regional veto players with a preference for low compensation accept a level of policy that is somewhat below the preferred level of the lower house. In turn, regional veto players that prefer high compensation accept the proposal of the lower house, which leads to the lower house's preferred level of policy. At high average levels of demand, the presence of an upper house dominated by regional interests that

prefer low compensation leads to a significantly low levels of compensation, as regional veto players only accept a proposal from the lower house that is within the interval $[0, 2c_{UH}^l]$, which is substantially lower than the ideal point preferred by the lower house. Lastly, where regional veto players prefer high compensation, the lower house's proposal is accepted and becomes policy.

Across countries, the presence of an upper house with legislative authority should in expectation lead to lower levels of compensation relative to where the former does not exist, and this should hold for both majoritarian and proportional rule. Assuming some uncertainty about the distribution of regional legislators' preferences in the real world, in some cases regional veto players may lie to the right of the ideal point preferred by pivotal legislators in the lower house and thus prefer greater compensation, while in others they may lie to the left and prefer lesser compensation. In the first case, the presence of a strong upper house will not lead to substantial changes in policy relative to unitary countries, and outcomes will be driven by electoral rules. In the second case, a strong house will lead to lower levels of policy and outcomes will be driven to a lesser extent by electoral rules. In expectation, therefore, in the presence of an upper house electoral rules should lead to lower levels of compensation relative to unitary countries. In addition, this reductive effect should be greater at high levels of demand. In bicameral systems with a strong upper house, electoral rules are thus expected to make less of a difference. In the absence of a strong upper house, the effect of electoral institutions mirrors that described in the previous section. These implications are summarized in Figure 2.6. The graph displays the policy outcome as a function of demand for compensation on the x-axis, and different electoral and legislative institutions. The solid lines indicate policy outcomes chosen under alternative electoral rules in the absence of a strong upper house. The dotted lines show policy outcomes under different electoral

rules in the present of a strong upper house. For a given electoral system, the conditioning effect of the upper house is apparent in the reduced slope.

Finally, it is worth noting that the above assumes that existing levels of compensation are very low (zero). Like most models, this simplifying assumption is aimed at clarifying the logic and thus cannot capture all possible scenarios. However, situations exist where the level of compensation is not so low. If the status quo is such that the ideal point of the UH lies to the right of q , and those of either c_{PR} or c_{Maj} lie to the left of q , the resulting policy will differ very little from the status quo, as UH accepts any proposal that lies within the interval $[q, 2y_{UH}^h - q]$ and this comprises q .

2.4 Summary and empirical implications of the argument

The argument outlined above argues that compensation in the aftermath of trade liberalization is the joint outcome of demand stemming from a diverse map of regional interests and the supply of policy linked to a set of institutional mechanisms. It generates testable implications at the individual and the national level.

At the individual level, it posits that regional specialization and competitiveness jointly shape the ease with which losing factors are reemployed in the event of job loss, and through it demand for compensation. Workers employed in losing industries in specialized uncompetitive regions are expected to demand high compensation relative to similar individuals in uncompetitive regions with a more diversified industrial base. While workers in losing industries in diversified competitive regions are expected to demand low compensation, similar individuals in specialized regions are expected to show more variable preferences.

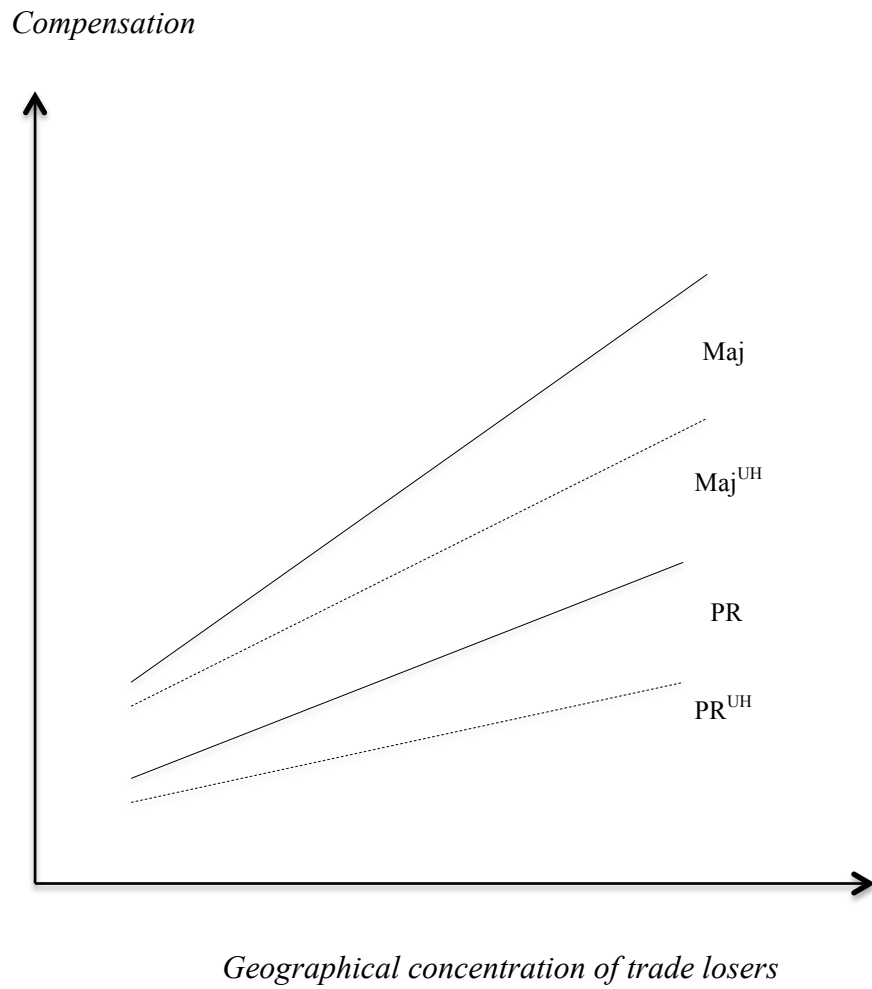
At the national level, the effect of electoral institutions on policy is contingent on the underlying structure of demand for compensation. Where trade losers are geographically

concentrated, policymakers in countries governed by majoritarian rules provide greater compensation relative to those governed by PR. Where trade losers are geographically dispersed, policymakers in both majoritarian and proportional systems will provide relatively lower levels of compensation, and the differences between electoral rules will be significantly reduced.

Finally, the presence of a strong upper chamber in bicameral systems generates institutional veto players with incentives to respond to geographically defined interests. This has observable implications within and across countries. In expectation, the presence of an upper house with legislative authority should lead to lower levels of compensation under both majoritarian and proportional rule. In the absence of a strong upper house, the effect of electoral institutions mirrors that described in the previous paragraph. Within countries, the presence of a strong upper chamber dampens levels of compensation where regional veto players in the upper house prefer lower levels of policy, and this reductive effect is larger when the level of demand in the economy is higher.

The argument lays out a clear set of hypotheses on the preferences of workers affected by trade, and on how political institutions shape the relationship between preferences and policy outcomes. The following chapters are devoted to testing these claims. Chapter 3 and Chapter 5 address the implications of the argument at the individual level. Chapter 4 is devoted to testing some of the main implications at the macro-level. Chapter 6 sheds light on some of the assumptions underpinning the macro-level hypotheses and clarifies how legislators' preferences play out in the presence of a second chamber.

Figure 2.5. Predicted effect of electoral rules on compensation across bicameral and unitary systems, conditional on level of demand



Testing the micro-foundations of compensation: the role of regional specialization

The theoretical argument developed in Chapter 2 is concerned with the relationship between trade exposure and compensation policy. However, it relies heavily on a number of assumptions regarding individual preferences. Specifically, the argument claims that losing interests in economically specialized uncompetitive regions support compensation more strongly than those in uncompetitive regions with a diversified industrial base. The present chapter tests the micro-foundations of the argument and paves the way for an analysis of the macro-level implications in Chapter 4.

The analysis draws on survey data from the European Social Survey over the period 2002-2006. The choice of survey reflects a concern to maximize regional variation, making it possible to capture most of the theoretical relationships posited in Chapter 2. However, the statistical analysis poses some limitations. One caveat is the limited temporal variation. Another caveat is that the measure of regional specialization employed in the analysis captures only part of the range of specialization values posited by the theory. In the extreme, highly specialized regions are characterized by the presence of one or two industries. This possibility is unlikely to be captured at the level of aggregation on which the measure is based.

The goal of this chapter is to present evidence of the micro-foundations underlying the argument, and thus to test whether the core assumptions of the theoretical model are accurate. It proceeds as follows. Section 1 briefly recalls the argument and outlines the micro-level implications. Section 2 explains the choice of survey used in the analysis,

and how levels of competitiveness and regional specialization are defined. Section 3 provides some descriptive data. Section 4 presents a logit multilevel random-intercept analysis of individual preferences for compensation. The results in Section 5 support the theoretical claims. Section 6 concludes and discusses the findings in the light of the argument.

3.1 Micro-level implications

The argument in Chapter 2 builds on three distinct concepts (exposure to international competition, regional competitiveness and regional specialization) and claims that it is the interaction of regional specialization and competitiveness that shapes preferences for compensation among individuals exposed to (negative) income effects of trade. To recall, losing individuals in uncompetitive and specialized regions face negative returns from trade, and in the event of a shock, limited outside options together with correlated demand between sectors constrain mobility. Moreover, low regional competitiveness constrains the capacity of employers to absorb labour *despite* the presence of positive externalities. Those employed in losing industries in specialized and uncompetitive regions are expected to support high compensation. Those facing lower income as a result of trade in diversified and uncompetitive regions face lower levels of uncertainty than trade losers. Low competitiveness limits positive externalities and constrains reemployment across sectors. But a diversified industrial base increases outside options in the event of a shock, both because of the higher number of alternative sectors to move to and the lower likelihood of downturn in the event of a sector-specific shock. Relative to specialized trade losers, therefore, trade losers in diversified and uncompetitive regions should support somewhat lower levels of compensation.

In turn, individuals facing lower income from trade in competitive regions are expected to demand relatively low levels of compensation. Those in diversified and competitive regions face greater outside options and benefit from the employment effects of diversification. This should dampen levels of support for compensation. In specialized regions, positive externalities and high competitiveness dampen labour market risk, but limited mobility increases support for compensation. This generates ambiguous predictions, and should lead to more variable support.

In sum, the positive effect of trade on demand for compensation should be more pronounced among those facing negative returns in specialized and uncompetitive regions than among similar individuals in diversified regions. In turn, the positive effect of trade on demand should be significantly dampened among losing individuals in competitive regions. Table 3.1 summarizes these predictions.

Table 3.1. Preferences over compensation, by level of regional specialization and competitiveness.

Competitiveness	Low specialization	High specialization
Low	Medium compensation	High compensation
High	Low	Low/Medium

3.2 Defining regional competitiveness and specialization

To evaluate whether individual preferences towards compensation correlate with the trade flows in industries in which individuals are employed and features of the regional economic context, the analysis relies on a rolling cross-section of survey data provided by the European Social Survey (ESS) for the period 2002-2006, complemented with regional level data on trade and employment by sub-sector. The data cover 15 industries

in 17 European countries and 166 regions over the period 2002-2006. European Social Survey data include consistent regional level identifiers that make it possible to match individual and regional information.⁵⁴ The analysis is limited to surveys collected between September 2002 and August 2006. The fourth wave of ESS (2008-2009) was excluded because the shadow of financial crisis already loomed large in 2008. The 17 countries included in the analysis are Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Poland, Portugal, Slovakia, Spain, Sweden and the United Kingdom. This rolling cross-section increases macro-level regional variation, although for obvious reasons the temporal variation is limited. In addition to maximizing regional variation, aggregating regions over time makes it possible to exploit variation in regional dynamics at a level much more proximate to individuals than analyses at the national level.

The focus of the analysis is mainly on manufacturing industries at the sub-sector level. The 15 industries are classified according to the NACE Rev. 1.1.⁵⁵ Among the manufacturing industries (Section D) are: Food products, beverages and tobacco (DA), textiles and wearing apparel (DB), leather and leather products (DC), wood and wood products (DD), pulp, paper and publishing (DE), chemicals and chemical products (DG), rubber and plastic products (DH), non-metallic mineral products (DI), basic metals and fabricated metal products (DJ), machinery and equipment (DK), electrical and optical equipment (DL), transport equipment (DM) and furniture (DN). Also included are electricity, gas and hot water supply (E40) and collection, purification and distribution of water (E41). The industry data used at this level were taken from Eurostat. Focusing on the sub-sector level increases variation at the industry level. This stands in contrast

⁵⁴ The ESS provides access to cumulative data from countries that have been included in the integrated ESS files in two or more rounds. This makes it possible to obtain usable regional sample sizes.

⁵⁵ This refers to the Statistical Classification of Economic Activities in the European Community, and is industry standard classification based on a 6-digit code.

with most studies exploring the effect of trade exposure on spending preferences and outcomes, which employ trade data at the sector level (Walter 2010, Rehm 2009). In turn, increased variation at the sub-sector level makes it possible to address substantively important issues, such as whether differences in the size of imports or exports (and not just the presence of trade flows) shape patterns of support. However, this necessarily excludes other sectors from the analysis. To the extent that manufacturing industries constitute the bulk of tradable sectors in most economies, this should be less of a problem.⁵⁶

The dependent variable is measured using an item on support for the reduction of income differences. The ESS item elicits a respondent's support for the statement "the government should take measures to reduce differences in income levels" measured on a 5-point agree-disagree scale. The variable was transformed into a dichotomous dependent variable and the scale reversed to ease interpretation. The measure takes on value 1 if the individual agrees strongly or agrees with the statement, and value 0 if the individual neither agrees nor disagrees, disagrees or strongly disagrees. Admittedly, this raises questions on whether redistribution captures compensation. A complementary analysis would use a more fine-grained policy measure. However, there are also clear advantages to using an umbrella redistribution measure. As defined in Chapter 2, compensation concerns general social insurance and spending programs that redistribute income (at least ex post). Moreover, specific policy instruments (whether active or passive labor market policy) used to compensate may vary across countries. Using an item about the reduction of income differences is thus likely to capture a substantial amount of variation in preferences over compensation in an open economy. In turn, from

⁵⁶ Primary extractive industries such as manufacturing of energy (coal, gas and petroleum) are excluded. This sector is almost always a significant outlier in every country. Extractive sectors such as mining or crude petroleum are "strategic" sectors marked by high dependence on imports and very little exports. Generally, outside production does not enter into competition with internal production, except for coal production mainly located in Eastern Europe.

a statistical point of view, the correlation between the item on the reduction of income differences and spending items pertaining to the level of support for unemployment benefits in international surveys such as the ISSP is high (0.7).⁵⁷ At worst, this indirect measure should provide a hard test of the argument: on the assumption that preferences for redistribution and preferences for trade-related compensation are correlated, more precise measures of the latter should lead to better estimates.

Empirically, the argument implies that individual support for compensation depends on three main explanatory variables: imports faced by the industry in which individuals are employed, regional specialization and regional competitiveness. Two of the three main explanatory variables, individual imports and regional competitiveness, are measured using trade data at the industry level for 15 two-digit NACE Rev. 1.1 industries from 2002 to 2006. Trade data comprise trade in goods with countries inside and outside the EU15. A first measure of individual exposure to imports, *Import exposure*, is an industry-specific variable and is estimated by computing the share of imports over a measure of gross value added for each industry in the sample. Distinguishing between individual exposure to imports and exports is necessary to capture the effect of exposure to foreign competition posited by the argument.⁵⁸ The analysis thus also includes a measure of exports at the individual level, *Export exposure*, which computes the ratio of sub-sector specific exports over gross value added. In addition, including this variable helps to minimize concerns about omitted variable bias because of the high correlation

⁵⁷ This is the case with ISSP 1996, which includes an item on whether individuals support greater spending on unemployment protection. Unfortunately, using the ISSP 1996 severely constrains the use of regional employment data across countries.

⁵⁸ Scholars have increasingly argued that relying on a measure of trade volume (imports plus exports over a measure of output) arguably does not adequately capture the income effect of trade that operates through changes in factor prices. For factor prices to change, a country need not trade a great deal with the rest of the world. Rather, producers in a country must compete with producers elsewhere. As argued by Wibbels and Ahlquist (2012: 454), “[a] country’s trade volumes are determined by a host of factors like geography and country size that are independent of the extent to which domestic factor prices deviate from those that would prevail were there no political or other barriers to trade”. Recent research also uses measures of imports as indicators of foreign competition (Rickard 2012a).

between imports and exports (Rickard 2012a: 1178). The industry data was then matched with the information on the respondent's industry of employment, with respondents being assigned their import share. A measure of total trade is substituted for imports for robustness. This was computed as the sum of imports and exports over gross value added, also matched to respondent's industry of employment.

The measure of *regional* competitiveness is the weighted sum of industry-specific share of imports over gross value added, where the weight is the share of regional employment (also at the industry level).⁵⁹ *Regional imports* thus gives an average measure of regional exposure to imports, and covers the 15 industries described above. Also included is a regional measure of sector-specific exports over value added, *Regional exports*. This variable is computed analogously. These new variables capture the degree to which a region is reliant on importing sectors, and speak directly to the theoretical concerns identified above.

The variable for regional specialization is estimated using a Herfindahl-Hirschmann Index of geographical concentration.⁶⁰ The measure is based on the sum of squares of employment shares for each industry in a region.⁶¹ Regions were defined as units where individuals can be expected to search for a job. Because this is likely to be shaped by a number of regional characteristics, such as distance, language or the provision of social services, regions were defined at different levels of NUTS depending on the extent to

⁵⁹ Given by the following expression: $\text{Regional Competitiveness}_r = \sum (\text{Imports}_i / \text{GVA}_i) * s_{ir}$, where the subscript i denotes industry, and s is the share of employment of industry i in region r . Regional employment data is available from Eurostat and is coded on the basis of the two-digit NACE Rev. 1.1 classification and the Nomenclature of Territorial Units for Statistics (NUTS).

⁶⁰ The index is given by the following expression: $\text{HHI}_i = \sum s_i^2$ where s is the regional share of employment in industry i .

⁶¹ Combining the regional data with survey data imposes limitations, and not all regions could be defined according to the above criterion. Some regions were coded according to the ESS classification. Table 1 in the Appendix shows the selection of regions.

which such characteristics are likely to be reflected in one territorial unit or another.⁶²

Calculated in this way, *Regional specialization* captures the degree of concentration of employment *within a region*. It compares the distribution of employment in one region with a uniform distribution in which employment is equally spread across all industries in the region. It is a proxy for the extent to which workers are able to find alternative employment across sectors in a region. The value of *Regional specialization* increases with the degree of geographical concentration, taking higher values when employment in a region is concentrated in a few industries, and lower values when regional employment is equally distributed across all industries in a region.⁶³

Several other variables are included in the analysis. Among the individual-level controls are age, gender, education, union membership, skill specificity and religion.⁶⁴ Including socio-demographic variables such as age, gender, education and union membership captures differences in expected income (and thus preferences for compensation) by factors independent of the argument. A measure of skill specificity was included to engage with arguments in the social insurance literature in political economy that claim that individuals who have made risky investments in specific skills will demand insurance against potential loss of income in the future (Iversen and Soskice 2001). The variable was coded following Fleckenstein, Saunders & Seeleib-Kaiser (2011). ISCO88 two-digit data was used to classify “elementary occupations”, “service workers and shop and market sales workers” and “clerks” as occupations requiring low-general skills (reference category, taking on value 0). Individuals with high-general skills comprise “legislators, senior officials and managers”, “professionals” and “technicians and

⁶² The NUTS classifies administrative divisions of European countries for statistical purposes, and may have different levels.

⁶³ As an absolute measure, the Herfindahl-Hirschmann Index displays a weighting towards large industries. Industries in a region with larger shares of employment have a larger influence on the index.

⁶⁴ Education ranges from 0 to 4, with 0 = less than lower secondary education, 1 = lower secondary education completed, 2 = upper secondary education completed, 3 = post-secondary non-tertiary education completed and 4 = tertiary education completed.

associate professionals” as holders of high-general skills (taking on value 1).⁶⁵ “Craft and related workers” and “plant and machine operators and assemblers” are classified as groups of occupations that require industry-specific skills. Previous research has emphasised the role of religion in redistribution preferences (Scheve and Stasavage 2006). Included are thus measures for religious denomination and attendance. Religion is expected to have an additional effect, unconnected to the link between trade and compensation.

The basic specification purposefully excludes variables such as ideology and unemployment status. The inclusion of demographics already incorporates differences in expected income (and thus preferences) driven by factors that are not captured by the explanatory variables, and adding additional controls such as ideology may lead to post-treatment bias. Since the argument is that regional economic structure affects preferences for compensation policy and these are likely captured by ideology, controlling for ideology makes little theoretical sense. This argument is relatively common in the political economy literature (Iversen and Soskice 2001). The same applies for measures of unemployment at the individual or regional level, as they are arguably measures of realized risk. Nonetheless, a number of such variables are included as robustness checks below. Although the same would apply to individual income, including a measure of individual income makes it possible to speak to the literature on redistribution. While it is common to control for levels of inequality in aggregate models of redistribution (through a Gini coefficient, for instance), individual level predictions of models drawing on Meltzer-Richard (1981) imply that relative income shapes support for redistribution. In this respect, the measure of individual

⁶⁵ In terms of education and skill portability, technicians and associate professionals fall between professionals, on one hand, and craft and related workers, on the other. However, a large segment of occupations in this group, such as those in computing, teaching, life sciences, and sales, can be assumed to be relatively transferable across firms and industries.

income captures an individual respondent's position in the income distribution, and thus constitutes a measure of relative income.

Included at the regional level are regional per capita GDP, a measure of total employment in manufacturing in a region and a measure of regional social expenditure. If regional specialization interacts with competitiveness, adding a variable controlling for regional employment in manufacturing should put the argument to a stricter test.⁶⁶ Including this variable also controls for the possibility that de-industrialization is driving changes in compensation (Iversen and Cusack 2000). In addition, an alternative explanation to the above hypotheses revolves around pre-existing levels of spending. Levels of regional specialization may be correlated with variables that affect the level of spending and through it support for compensation. Industrial agglomeration underlying regional specialization dynamics may be partially driven by industrial policies seeking to foster competitiveness. This may, in turn, be correlated with generous welfare states (Katzenstein 1985). Individuals may also take into account existing levels of redistribution when expressing preferences over compensation. According to some scholars, individuals in countries with large welfare states are more likely to be aware of the disincentive effects of redistribution (Tanzi and Schuknecht 2000). This may lead to dampened support for spending among losers and winners. *Regional social expenditure* thus takes into account regional spending levels by weighting national per capita social expenditure by the regional share of unemployment.

3.3 Descriptive statistics

Before delving into the analysis, the following section provides a descriptive assessment of the above claims. Table 3.2 provides descriptive data on imports and exports at the

⁶⁶ The ratio between employment in industry and total employment was calculated at the regional level. Data was obtained from Eurostat.

sector level, used to construct the measures of *Import exposure* and *Export exposure*. It shows imports and exports as a share of production (measured as gross value added), averaged over the period from 2002 to 2006. Net importing sectors are those where import share exceeded export share.⁶⁷ Table 3.2 shows data for sectors that face the largest shares of imports (exports) relative to exports (imports). A number of patterns stand out. First, the distribution of importing and exporting sectors varies substantially across countries. Countries such as Germany, France, Czech Republic and to a lesser extent, Belgium, are net exporting in capital-intensive industries such as chemicals, machinery or transport. They also tend to import labour-intensive products such as leather or food products. In contrast, Italy, Poland, Portugal, Spain and Slovakia tend to import capital-intensive products, and export labour-intensive products. Scandinavian countries such as Finland or Sweden tend to export wood and paper products. Secondly, countries such as Greece and the UK tend to be net importers across the board, perhaps reflecting their service-oriented economy.

⁶⁷ Original data on imports and value added are in million euros.

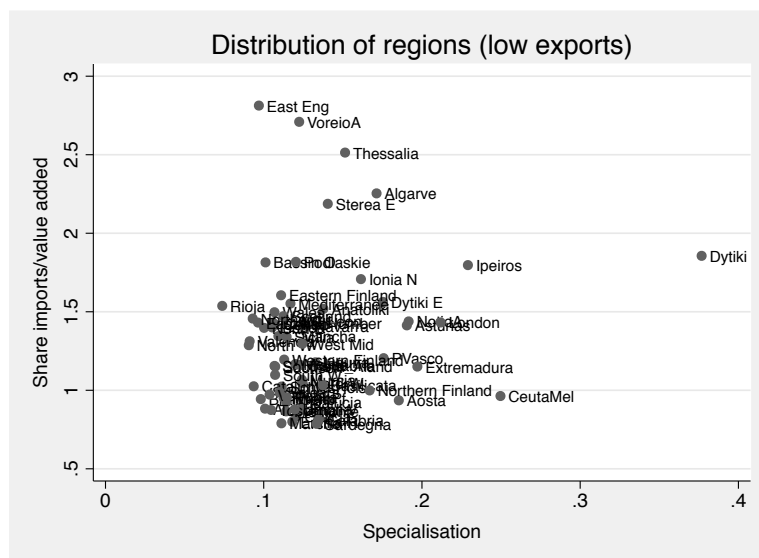
Table 3.2 Imports and Exports by sector of activity in 17 European countries, 2002-2006

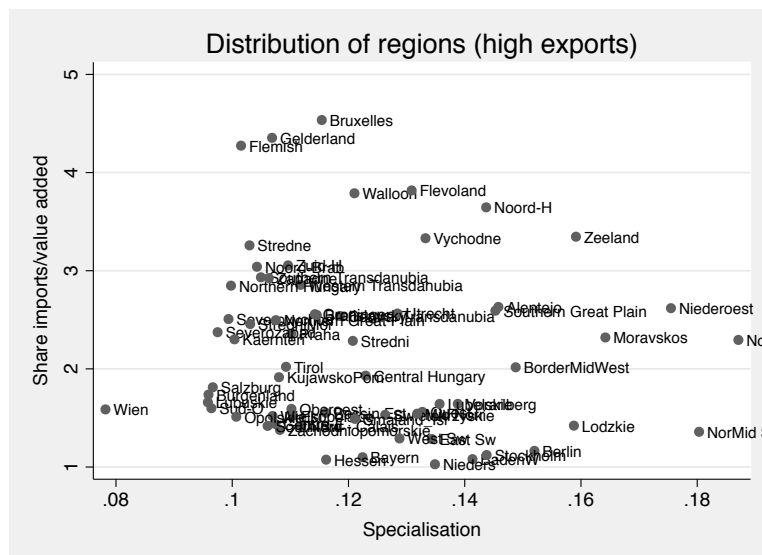
Country	Net importing sectors	Imports/GVA	Exports/GVA	Net exporting sectors	Imports/GVA	Exports/GVA
Austria	Textiles and textile products	4.63	3.1	Wood and wood products	0.66	1.65
	Leather and leather products	6.44	5.22	Pulp, paper and publishing	0.91	1.22
	Chemicals, chemical products	3.33	2.38	Machinery	1.78	2.31
Belgium	Pulp, paper and publishing	1.65	1.63	Leather and leather products	25.9	31.8
	Electrical equipment	6.66	5.94	Textiles and textile products	4.49	5.55
				Chemicals and chemical products	6.51	7.76
Czech Republic	Rubber and plastic products	2.31	2.05	Wood and wood products	0.5	1.04
	Leather and leather products	6.91	3.47	Non metallic minerals	0.66	1.27
	Chemicals, chemical products	4.9	2.49	Transport equipment	2.21	3.56
Germany	Food products and tobacco	0.81	0.8	Chemicals and chemical products	1.48	1.81
	Textiles and textile products	3.85	2.61	Machinery	0.63	1.56
	Leather and leather products	6.17	3.25	Transport	1.15	2.25
Spain	Chemicals, chemical products	2.14	1.44	Food products and tobacco	0.84	0.8
	Machinery	1.89	1.05	Leather and leather products	1.6	1.73
	Electrical equipment	3.68	1.7	Non-metallic minerals	0.26	0.47
Finland	Textiles and textile products	3.44	1.23	Wood and wood products	0.28	1.84
	Leather and leather products	3.58	1.26	Pulp, paper and publishing	0.14	1.57
	Chemicals, chemical products	2.44	1.41	Electrical and optical equipment	1.15	1.71
France	Textiles and textile products	2.82	1.8	Chemicals and chemical products	2.32	2.63
	Leather and leather products	4.17	2.95	Food products and tobacco	0.81	1.02
	Electrical and optical equipment	2.56	2.23	Transport	3.05	3.86
UK	Textiles and textile products	3.3	1.2	Chemicals and chemical products	1.6	1.74
	Leather and leather products	7.75	1.95			
	Wood and wood products	1.08	0.13			
Greece	Chemicals, chemical products	5.13	1.39	Textiles and textile products	1.58	1.31
	Electrical and optical equipment	5.67	1.11			
	Transport equipment	11.18	0.68			

Hungary	Leather and leather products	4.69	3.3	Food products and tobacco	0.71	0.98
	Basic metals and fabricated metal products	2.87	1.72			
	Machinery	4.33	3.26			
Ireland	Leather and leather products	10.45	2.1	Chemicals and chemical products	0.56	3.07
	Machinery and equipment	3.69	2.22	Electrical and optical equipment	2.61	4.16
	Transport equipment	8.92	1.11	Food products and tobacco	0.63	1.25
Italy	Transport equipment	3.21	2.55	Leather and leather products	0.9	1.81
	Electrical and optical equipment	1.56	1.12	Textiles and textile products	0.74	1.31
	Chemicals, chemical products	2.31	1.6	Machinery	0.68	1.85
Netherlands	Wood and wood products	2.12	0.79	Chemicals and chemical products	2.97	4
	Textiles and textile products	7.82	6.51	Food products and tobacco	1.39	2.59
	Leather and leather products	17.1	15.12	Electrical and optical equipment	17.78	18.5
Poland	Electrical and optical equipment	3.64	2.31	Food products and tobacco	0.52	0.67
	Chemicals, chemical products	3.75	1.29	Wood and wood products	0.38	1.11
	Machinery	3.18	1.62	Transport	3.83	4.32
Portugal	Machinery	3.15	1.57	Textiles and textile products	1.02	1.56
	Electrical and optical equipment	4.9	3.15	Leather and leather products	1.12	1.89
	Transport equipment	6.08	4.06	Wood and wood products	0.56	1.52
Sweden	Food products and tobacco	1.2	0.67	Wood and wood products	0.4	1.62
	Textiles and textile products	7.05	3.38	Pulp, paper and publishing	0.29	1.42
	Leather and leather products	10.8	4.13	Machinery	1.24	1.91
Slovakia	Chemicals, chemical products	6.03	3.58	Leather and leather products	2.95	3.86
	Machinery	4.18	3.4	Wood and wood products	0.67	1.33
	Electrical and optical equipment	5.65	4.32	Transport	5.53	7.38

To illustrate variation at the regional level, Figure 3.1 shows the distribution of 127 regions by regional imports and regional specialization (Table A2 in the appendix provides data on the distribution of the explanatory variables). Because regions that are relatively more importing may also be exporting, the graphs sort regions with high and low levels of exports, according to the median level of the sample. Importing regions with low exports should on average be less competitive than similar regions with high exports. Although the variation in levels of regional specialization is greater among the latter, the top graph of Figure 3.1 shows considerable variation in terms of regional specialization among uncompetitive regions. Statistical tests also show that the correlation between *Specialisation* and *Competitiveness* is relatively low. Testing for the correlation between the two variables yields a negative coefficient of 0.08.

Figure 3.1. Share of regional imports over value added and regional specialization across European regions, 2002-2006.





Lastly, table 3.3 illustrates mean levels of support for compensation among individuals in regions that face relatively greater imports and are more specialized. Table 3.3 shows several important things. Firstly, levels of support for compensation are on average higher among voters in uncompetitive regions than competitive ones. Secondly, the highest levels of support are found among uncompetitive and specialized regions. In turn, differences in levels of support among competitive and uncompetitive regions in diversified regions are relatively small. This suggests that not all those in losing contexts prefer high levels of compensation. Lastly, average levels of support are lowest in regions that are both competitive and specialized. This suggests that in specialised and competitive regions individuals demand lesser compensation. Overall, these patterns lend confidence to the notion that the results form statistical analysis and not artifacts of the modeling choices.

Table 3.3. Mean level of support for compensation by level of regional specialization and competitiveness, 2002-2006

Regional competitiveness	Specialisation		Total
	Low	High	
Low	0.71	0.75	0.73
High	0.74	0.69	0.71
Total	0.73	0.72	0.72

3.4 The statistical model

The data presented so far provide some indication of the accuracy of the assumptions driving the argument, but do not control for the influence of potentially relevant factors.

The following analyses provide a more rigorous test of the hypothesized relationships.

The data are analysed using a logistic, three-level multilevel model with random intercepts. Multilevel models make it possible to examine the extent to which regional characteristics condition the relationship between exposure to competition and preferences for compensation. It is also appropriate for inferential reasons. Failure to account for the clustering of the data would violate the assumption of independent standard errors and would underestimate the errors for the regional effects (Rabe-Hesketh & Skrondal 2005, Snijders & Bosker 2004). A random intercept at both the region and the country level is included. The model takes the following form:

$$Y_{ijk} = \gamma_{000} + \gamma_{10} \text{Import exposure}_{ijk} + \gamma_{01} \text{Regional specialization}_{jk} + \gamma_{11} \text{Regional specialization}_{jk} * \text{Import exposure}_{ijk} + \gamma_1 X_{ijk} + \gamma_0 Z_{jk} + u_{00k} + u_{0jk} + r_{ij}$$

Where Y_{ijk} is the outcome for the i th individual in region j in country k . The parameters represented with a γ represent the fixed effects of the multilevel model, while u_{00k} and u_{0jk} represent the random effects. In order to test the effect of *Import exposure* and *Regional specialization* by level of regional competitiveness (*Regional imports*), the analyses are

carried out across samples of regions with high and low levels of competitiveness.⁶⁸ X_{ijk} represents a vector of individual level controls, and Z_{jk} represents a vector of regional level controls.

A first set of estimated models includes an interaction term equal to the product of *Import exposure* and *Regional specialization* in a sample of regions with low levels of competitiveness. Empirically, the interaction coefficient between *Import exposure* and *Regional specialization* among uncompetitive regions is expected to be positive and significant, indicating that individuals in industries facing greater imports in specialized and uncompetitive regions are most negatively affected by international imports. Relative to these individuals, those employed in importing industries in diversified regions are expected to exhibit lower levels of support, shedding a negative and statistically coefficient on the constitutive term for *Import exposure*.

A second set of models interacts *Import exposure* with *Regional specialization* across the sample of competitive regions. The argument in Chapter 2 does not generate unambiguous predictions for individuals in specialized and competitive regions. Since it claims that the effects of specialization and competitiveness may cancel each other out, this should lead to greater variability in support for compensation in specialized and competitive regions.

3.5 Findings

Table 3.4 reports the coefficient estimates for the multilevel model, which show that regional specialization and competitiveness condition the effect of imports on support for compensation.

⁶⁸ I thank Ben Ansell and David Doyle for this suggestion.

As a preliminary step, column 1 reports results from an additive benchmark model that pools observations from all regions. It does not include *Regional specialisation*. In line with the literature on the compensation hypothesis, the positive and significant coefficient for *Import exposure* indicates that individuals employed in importing industries exhibit stronger support for compensation, while those employed in industries facing greater exports (*Export exposure*) show decreased levels of support for compensation.

The control variables behave largely as expected. Richer and more educated individuals are less likely to support compensation. Females and union members support greater compensation. The effect of skill specificity varies across levels of regional competitiveness. Consistent with the social insurance literature, specific skills are positively associated with support for compensation relative to low-general skills, while high-general skills exhibit a negative association.

Columns 2 and 3 report the findings for the specification that includes the theoretically predicted interaction between *Import exposure* and *Regional specialization* across regions with low and high levels of regional competitiveness. Competitive regions are those with values below the median of the sample.⁶⁹ Column 2 corresponds to the sample of uncompetitive regions. As expected, the coefficient of the interaction term between *Import exposure* and *Regional specialization* is positive and significant, indicating that individuals employed in industries facing greater imports in specialized and globally uncompetitive regions support greater compensation relative to those in diversified regions. The constitutive term for *Import exposure* is negative and significant, indicating that individuals facing greater imports in diversified regions prefer lower compensation. Note also that the coefficient for specific skills is

⁶⁹ Recall that the variable measures the industry-specific ratio of imports over sector gross value added summed across sectors in a region. Lower values signify greater competitiveness.

statistically significant in uncompetitive regions. This may be an indication that skill specificity increases labour market risk in specialized and uncompetitive regions, further reducing mobility. This is consistent with the argument made in Chapter 2.

Column 3 in Table 3.4 also shows that for individuals facing greater imports, residing in a specialized and competitive region is associated with higher support, but not to a statistically significant extent. This suggests that greater regional specialization and high levels of competitiveness decrease risk among individuals facing greater imports.

Interestingly, the constitutive term for imports in column 3 is negative and insignificant, indicating that individuals employed in importing industries in diversified and competitive regions prefer lower compensation relative to those in specialized regions.

Table 3.4 Determinants of support for compensation in Europe, 2002-2006

	(1)	(2)	(3)
	All regions	Uncompetitive	Competitive
Import exposure	0.0719*	-0.4751**	-0.0240
	(0.0374)	(0.2342)	(0.5004)
Regional specialisation		-3.3171	-1.2225
		(2.3463)	(3.5481)
Import exposure*Specialisation		4.4178**	1.1024
		(2.0920)	(3.8997)
Export exposure	-0.2229**	-0.1002	-0.2467*
	(0.0731)	(0.1025)	(0.1416)
Regional exports		-0.2658**	0.2428
		(0.0846)	(0.3957)
Employment in industry	0.0196	-0.0236	0.0953**
	(0.0218)	(0.0190)	(0.0423)
Regional capita GDP	-0.0013	0.0005	-0.0007
	(0.0008)	(0.0010)	(0.0016)
Regional social expenditure	0.0011**	0.0003	0.0015**
	(0.0002)	(0.0003)	(0.0004)
Income	-0.0605**	-0.0610**	-0.0473**
	(0.0127)	(0.0171)	(0.0227)
Lower secondary education	0.0179	0.3431*	-0.2325
	(0.1061)	(0.1769)	(0.1626)
Upper secondary education	-0.2035**	-0.0721	-0.3773**
	(0.0983)	(0.1648)	(0.1485)
Post-secondary education	-0.5957**	0.0457	-0.9632**
	(0.2025)	(0.4098)	(0.2915)
Tertiary education	-0.7587**	-0.8304**	-0.8448**
	(0.1184)	(0.1999)	(0.1817)
Age	0.0005	0.0007	0.0007
	(0.0004)	(0.0005)	(0.0008)
Female	0.3175**	0.3362**	0.3406**
	(0.0600)	(0.0894)	(0.0975)
Union	0.3679**	0.2531**	0.4867**
	(0.0608)	(0.0897)	(0.1002)
Attendance	-0.0124	-0.0159	-0.0072
	(0.0225)	(0.0339)	(0.0358)
Denomination	-0.0087	0.1268	-0.0874
	(0.0710)	(0.1115)	(0.1057)
High general skills	-0.2962**	-0.1648	-0.3139**
	(0.0855)	(0.1301)	(0.1341)
Specific skills	0.1188	0.2638**	0.0798
	(0.0753)	(0.1127)	(0.1198)
Constant	0.7580	2.7758**	-1.4969
	(0.6422)	(0.6794)	(1.4319)
Observations	7798	3317	3205

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

How big are these effects? Figure 3.2 plots the marginal effect of import exposure on support for compensation, conditional on regional specialisation and regional competitiveness (based on the specification in column 2). The line depicts the marginal

effect of *Import Exposure* and the boxes around the points show the 95% confidence intervals. Figure 3.2 demonstrates that the marginal effect of import exposure on preferences in uncompetitive regions varies across levels of regional specialisation. At moderate and high levels of specialisation, higher exposure is clearly associated with a significant increase in support for compensation. The marginal effect of *Import exposure* is statistically significant at the 0.05 level when the upper and lower bounds of the confidence intervals are above zero. For uncompetitive regions, the marginal effect of *Import exposure* on support for compensation increases as regional specialisation increases. The effect is substantively large: for a given level of import exposure, increasing specialisation from 0.11 to 0.38 leads to an increase in support for compensation of almost 25 percentage points. The effect is less precisely estimated at very high levels of specialisation, but at middle levels the marginal effect is considerable and is precisely estimated. Thus, among uncompetitive regions, exposure to imports has a positive effect on support for compensation as regional specialisation increases.

Figure 3.2. Marginal effect of *Import exposure* on support for compensation, conditional on regional specialization (for uncompetitive regions)

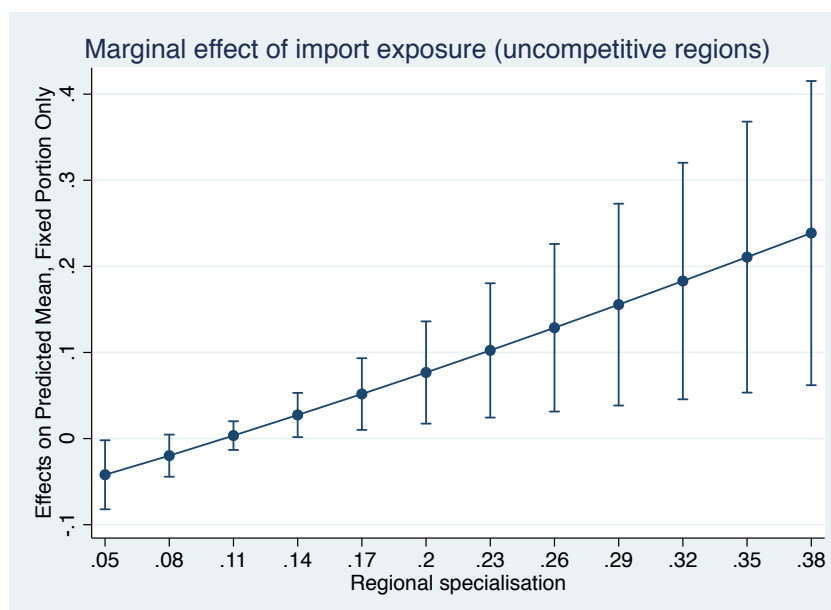


Figure 3.3. Marginal effect of *Import exposure* on support for compensation, conditional on regional specialization (for competitive regions)

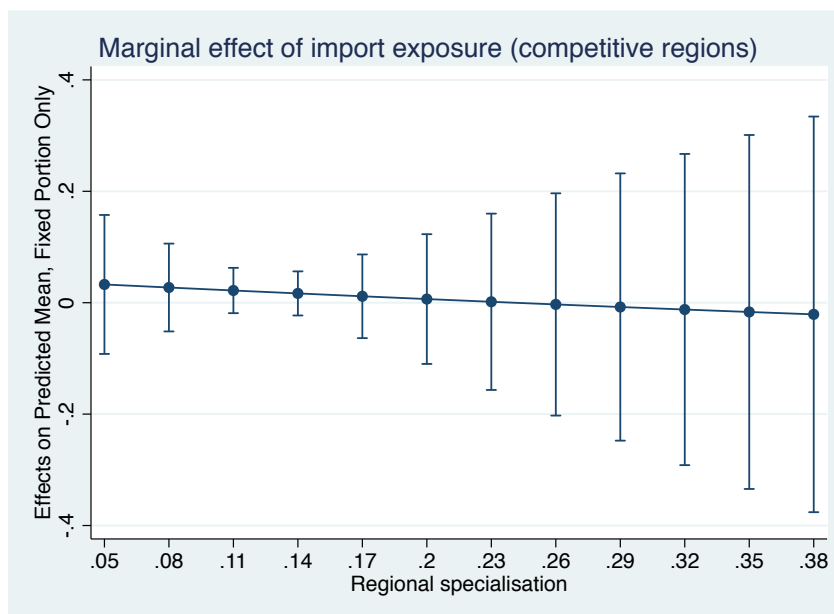


Figure 3.3 plots the marginal effect of *Import exposure* for the sample of competitive regions, conditional on levels of specialisation (based on the specification in column 3). The marginal effect is essentially zero. While the effect is precisely estimated at low levels of specialisation, at high levels of specialisation it is not. Consistent with the argument, this suggests that in specialised and competitive regions the effects of specialisation are likely to cancel each other out.

Might a simpler specification account for the above findings? For example, do individuals in importing industries in uncompetitive regions exhibit the same patterns of support, regardless of regional specialization? An additional set of models tests whether *Import exposure* shapes preferences for compensation jointly with *Regional specialization* (column 3) and *Regional Imports* (column 2). The results are presented in the appendix (Table A3). The interaction terms in column 2 and column 3, respectively, produce insignificant positive and negative coefficients. The null findings provide

support for the notion that the effect of imports on preferences over compensation is conditional on *both* regional specialization and competitiveness. They show that neither regional specialization nor competitiveness alone can account for patterns of support for compensation among globalization losers and winners. Rather, it is the combination of specialization, competitiveness and individual returns to trade that best accounts for patterns of demand.

The above findings are robust to alternative measures of trade. The argument developed above relies on a measure of imports to capture the effect of foreign competition.

However, since many studies rely on a measure of the volume of trade, Table A4 in the appendix replicates the models in Table 3.4 but replaces the measure of individual imports with a measure of trade volume. The predicted probabilities in Figure 3.4 in the appendix show that results do not conform to expectations with the measure of trade volume at the individual level. This may be an indication that the preferences of importing and exporting factors are being conflated. In addition, the findings are robust to the inclusion of additional control variables.⁷⁰ A measure of regional unemployment and an indicator variable for whether the individual was unemployed are included in Table A4. Since the effect of greater exposure on individual returns is already captured by the demographic variables in the basic model, such variables are likely to be post-treatment. Nonetheless, the findings in Table 3.4 show that the results hold with the inclusion of such variables.

Lastly, the analysis is replicated with a measure of regional gross value added growth. If regional competitiveness shapes demand for compensation jointly with specialization, this relationship should hold with a measure of production at the regional level. It would

⁷⁰ They are also robust to different multilevel specifications. Since it is theoretically possible that the effect of imports or exports varies across the population of regions, the latter were treated as random effects. This assumes that the effect of imports varies randomly within the population of regions. Including a random slope for imports and exports does not change the results.

be difficult to argue that a region that is not on average adding value is competitive internationally. Columns 7 and 8 thus replicate the basic model but split the sample across regions with high and low value added growth. The interaction term for the sample of regions with low value added is positive and significant, indicating that individuals in importing industries in specialized regions with low value added (column 8) demand greater compensation relative to those in diversified regions. The interaction term for regions with high value added growth sheds a positive but insignificant coefficient, echoing that in Table 3.4 above.

3.6 Conclusions

This chapter has evaluated the micro-level implications of the argument outlined in Chapter 2. The analysis emphasizes that regional economic specialization and regional competitiveness jointly condition the impact of trade on preferences for compensation in European regions. Trade losers exhibit differences in support, and such differences are contingent on the extent to which regions are specialized and competitive. Individuals facing greater imports demand more compensation than those facing lesser imports when regions are specialized and uncompetitive. Such individuals face increased risk in the event of unemployment, and turn to the state for increased protection. As regional specialization decreases, support for compensation among those that stand to lose from trade in uncompetitive regions is dampened. These individuals face some level of risk, but have greater outside options in the event of job loss. In contrast, at low levels of regional competitiveness, differences between trade losers are significantly reduced. In addition, the greater variability in the estimates of support for compensation in specialized and competitive regions is consistent with the expectation that in such regions, the effects of specialization and competitiveness cancel each other out.

In line with existing studies, the findings suggest that there is no generalized (positive) relationship between exposure to competition and preferences for compensation. The results thus build on previous studies that emphasise the rich variation underpinning demand for compensation (Rickard 2006, Rickard 2012, Walter 2010). The above analysis delves further into the sources of preference heterogeneity, and suggests that economic geography may have an important role in conditioning the effect of trade on individual preferences. It highlights the need to take into account geographical context as a source of labour market risk in open economies. Although in expectation workers employed in industries facing greater imports stand to from trade, there may be mechanisms linked to economic geography that may increase or decrease the risks associated with increased foreign competition.

In addition, by explicitly unbundling the ties that bind international competition and demand for compensation, the analysis has implications for the contested debate on the conditions that lead policymakers to provide greater social protection. Echoing earlier research, the findings suggest that the extent to which compensation dynamics are under play will depend on the degree of preference heterogeneity (Rickard 2006, Beramendi 2012). The *compensation hypothesis* is likely to hold in contexts where reemployment in the event of a shock is difficult – in specialized and uncompetitive regions – as workers within industries have strong incentives to demand increased compensation. In regional contexts where individuals are able to find employment relatively easily – in competitive regional economies – they face lower incentives to demand compensation. Ultimately, however, whether demand for compensation is reflected in policy will depend on how such heterogeneity is aggregated across institutional systems. This is addressed empirically in Chapters 4 and 6. More generally, the findings reinforce the notion that individual economic situation matters. However, they also point to research arguing that

support for redistribution is prevalent among groups that, on an income basis, are expected to exhibit different redistributive preferences (Rehm 2009, Beramendi 2012, Rueda and Stegmüller 2013).

Although they provide fairly solid evidence of the micro-foundations underpinning the argument, the findings present some limitations. The analysis would benefit from a complementary exploration using a more fine-grained dependent variable. As emphasized above, however, using an umbrella measure of income redistribution provides a number of advantages. The argument is concerned with redistribution of income from trade winners to losers. In addition, one advantage of using an item on redistribution is that countries may use different policy instruments to compensate (active or passive labor market policies). These differences are captured by the redistribution measure. The findings are also somewhat restricted by the range of variation on the specialization variable, which does not capture cases of extreme specialization. This is a trade-off that has to be accepted in order to test some of the major implications of the argument. To disentangle the theoretical mechanisms underlying the argument, Chapter 5 carries out an in-depth analysis of regions in Spain and Argentina. This makes it possible to look at the range of cases posited by the theory. Having explored the micro-foundations underpinning the argument, the following chapter explores the role of institutions in aggregating preferences into policy outcomes.

Appendix

Table A3.1. Descriptive statistics

Variable	Obs	Mean	St. Dev.	Min	Max
<i>Individual level</i>					
Reduction income differences	91147	0.7253	0.4463	0	1
Import exposure	9524	0.8125	1.255	0.0217	15.389
Export exposure	9524	0.7557	0.6600	0.0213	7.221
Industry employment	93517	26.92	5.517	19.01	40.09
Income	86715	4.7458	2.437	1	9
Education	92871	1.857	1.322	0	4
Age	93467	54.68	86.50	13	94
Gender	93291	0.5349	0.4987	0	1
Union membership	92807	.4011	.4901	0	1
Church attendance	93056	2.683	1.588	1	6
Denomination	90996	0.633	0.481	0	1
Unemployed	93467	.039	.194	0	1
Skill specificity	78485	0.824	0.771	0	2
<i>Regional level</i>					
Specialisation	92595	0.120	0.027	0.049	0.402
Regional imports	71084	1.957	0.969	0.582	4.954
Regional exports	71084	1.959	1.094	0.519	5.370
Regional capita GDP	92595	167.62	83.76	1	300
Regional social expenditure	86999	456.0	266.3	99.33	2064.1
Regional unemployment	86999	8.3862	4.974	2.3	27.3

Table A3.2. Regional share of imports over value added, regional share of exports over value added and regional specialization in 127 regions, averaged 2002-2006

Country	Region	Regional			Specialisation
		1 Imports	2 Expor	1 - 2	
Belgium	Brussels region	4.536	4.78	-0.25	0.116
Belgium	Flemish region	4.274	4.62	-0.35	0.102
Belgium	Walloon region	3.789	4.23	-0.44	0.122
Czech	Prague	2.359	2.36	-0.00	0.111
Czech	Central Bohemia	2.286	2.56	-0.28	0.121
Czech	Northwest	2.374	2.44	-0.07	0.098
Czech	Northeast	2.508	2.70	-0.19	0.10
Czech	Central Moravia	2.457	2.57	-0.11	0.104
Czech	Moravskos	2.32	2.45	-0.13	0.165
Germany	Baden Württemberg	1.081	1.53	-0.45	0.142
Germany	Bavaria	1.1	1.48	-0.38	0.123
Germany	Berlin	1.165	1.45	-0.28	0.152
Germany	Brandenburg	0.944	1.29	-0.35	0.099
Germany	Hesse	1.075	1.45	-0.37	0.117
Germany	Lower Saxony	1.028	1.45	-0.42	0.135
Germany	North Rhine-Westphalia	1.046	1.33	-0.29	0.125
Germany	Rhineland-Palatinate	0.954	1.32	-0.37	0.113
Germany	Saxony	1.151	1.35	-0.20	0.108
Germany	Schleswig-Holstein	1.024	1.27	-0.25	0.112
Ireland	Border, Midland and West	2.016	2.07	-0.05	0.149
Greece	East Macedonia/Thrace	1.519	0.57	0.94	0.138
Greece	West Macedonia	1.857	0.79	1.05	0.377
Greece	Thessaly	2.514	0.64	1.87	0.152
Greece	Epirus	1.797	0.64	1.15	0.23
Greece	Ionian Islands	1.708	0.55	1.15	0.162
Greece	West Greece	1.563	0.59	0.96	0.176
Greece	Central Greece	2.188	0.63	1.55	0.141
Greece	North Aegean	2.71	0.57	2.13	0.123
Greece	South Aegean	1.439	0.52	0.91	0.192
Spain	Galicia	0.836	0.71	0.12	0.121
Spain	Asturias	1.414	1.11	0.29	0.191
Spain	Cantabria	1.161	0.83	0.32	0.124
Spain	Basque Country	1.205	0.92	0.27	0.176
Spain	Navarre	1.411	0.97	0.43	0.127
Spain	La Rioja	1.538	1.17	0.36	0.074
Spain	Aragon	0.883	0.94	-0.05	0.101
Spain	Castile Leon	1.438	0.98	0.45	0.126
Spain	Castile Mancha	1.345	1.04	0.30	0.11
Spain	Extremadura	1.151	0.77	0.37	0.198
Spain	Catalonia	1.026	0.74	0.28	0.094
Spain	Valencia	1.313	1.04	0.27	0.092

Spain	Balearic Islands	0.989	0.77	0.21	0.111
Spain	Andalusia	0.925	0.75	0.16	0.115
Spain	Murcia	1.067	0.87	0.19	0.125
Spain	Ceuta & Melilla	0.964	0.79	0.16	0.25
France	Bassin Est	1.553	1.76	-0.21	0.117
France	Bassin Ouest	1.815	1.33	0.48	0.102
France	Nord - Calais	1.42	1.51	-0.09	0.112
France	East region	1.525	1.52	-0.003	0.111
France	West region	1.562	1.63	-0.06	0.133
France	Southwest region	1.599	1.42	0.17	0.097
France	Centre-East	1.438	1.57	-0.13	0.108
France	Mediterranean	1.552	1.36	0.16	0.117
Italy	Piemonte (Piedmont)	0.866	0.90	-0.04	0.115
Italy	Aosta Valley	0.936	1.25	-0.32	0.186
Italy	Liguria	1.179	0.81	0.36	0.133
Italy	Veneto	0.973	0.98	-0.01	0.104
Italy	Friuli-Venezia Giulia	0.881	1.02	-0.14	0.124
Italy	Emilia-Romagna	0.8	1.10	-0.30	0.119
Italy	Tuscany	0.875	1.01	-0.13	0.105
Italy	Umbria	0.879	0.96	-0.09	0.12
Italy	Marche	0.79	0.96	-0.17	0.112
Italy	Molise	1.167	1.06	0.10	0.121
Italy	Puglia	0.955	1.01	-0.05	0.115
Italy	Basilicata	1.033	0.96	0.07	0.138
Italy	Calabria	0.812	1.29	-0.48	0.135
Italy	Sicily	1.341	0.85	0.48	0.115
Italy	Sardinia	0.787	0.89	-0.10	0.134
Hungary	Central Hungary	1.931	2.21	-0.28	0.123
Hungary	Central Transdanubia	2.539	2.43	0.10	0.119
Hungary	Western Transdanubia	2.857	2.52	0.33	0.112
Hungary	Southern Transdanubia	2.933	2.65	0.28	0.105
Hungary	Northern Hungary	2.848	2.26	0.58	0.1
Hungary	Northern Great Plain	2.496	2.15	0.34	0.108
Hungary	Southern Great Plain	2.593	2.08	0.50	0.146
Netherlands	Groningen	2.557	3.59	-1.03	0.115
Netherlands	Gelderland	4.354	3.99	0.36	0.107
Netherlands	Flevoland	3.818	2.37	1.44	0.131
Netherlands	Utrecht	2.564	4.02	-1.45	0.129
Netherlands	Noord-Holland (North Holland)	3.646	3.16	0.47	0.144
Netherlands	Zuid-Holland (South Holland)	3.055	3.44	-0.39	0.11
Netherlands	Zeeland	3.347	3.12	0.22	0.16
Netherlands	Noord-Brabant (North Brabant)	3.041	5.35	-2.31	0.105
Austria	Burgenland	1.738	2.37	-0.64	0.096
Austria	Niederösterreich (Lower Austria)	2.619	1.53	1.08	0.176
Austria	Wien (Vienna)	1.587	2.30	-0.71	0.079
Austria	Kärnten (Carinthia)	2.301	1.66	0.63	0.101
Austria	Oberösterreich (Upper Austria)	1.592	2.02	-0.43	0.111

Austria	Salzburg	1.813	2.16	-0.35	0.097
Austria	Tyrol	2.022	1.80	0.21	0.11
Austria	Vorarlberg	1.644	1.81	-0.16	0.139
Poland	Lodzkie	1.422	1.79	-0.37	0.159
Poland	Lubelskie	1.643	1.72	-0.08	0.136
Poland	Swietokrzyskie	1.532	1.78	-0.25	0.127
Poland	Podlaskie	1.818	1.41	0.4	0.121
Poland	Wielkopolskie	1.52	1.48	0.03	0.107
Poland	Zachodniopomorskie	1.378	1.69	-0.31	0.109
Poland	Lubuskie	1.66	1.72	-0.06	0.096
Poland	Opolskie	1.513	1.74	-0.23	0.101
Poland	KujawskoPom	1.915	1.48	0.42	0.109
Portugal	Norte	2.295	1.47	0.81	0.188
Portugal	Algarve	2.254	1.26	0.98	0.172
Portugal	Centre	1.419	1.02	0.39	0.108
Portugal	Lisbon	1.401	1.27	0.12	0.106
Portugal	Alentejo	2.631	1.46	1.16	0.146
Slovakia	Bratislavsky (Bratislava)	2.549	2.51	0.03	0.115
Slovakia	Zapadne (Western Slovakia)	2.926	3.31	-0.38	0.107
Slovakia	Stredne (Central Slovakia)	3.259	2.76	0.49	0.103
Slovakia	Vychodne (Eastern Slovakia)	3.331	2.46	0.86	0.134
Finland	Eastern Finland	1.605	1.26	0.33	0.111
Finland	Western Finland	1.196	1.40	-0.20	0.113
Finland	Northern Finland	0.999	1.41	-0.41	0.167
Finland	Southern & Aland	1.156	1.41	-0.26	0.107
Sweden	Stockholm	1.122	1.58	-0.46	0.144
Sweden	Ostra Sverige (East Sweden)	1.286	1.79	-0.51	0.135
Sweden	Smaland med öarna (Smaland Islands)	1.491	1.71	-0.22	0.122
Sweden	Sydsverige (South Sweden)	1.419	1.63	-0.21	0.107
Sweden	Västsverige (West Sweden)	1.291	1.60	-0.31	0.129
Sweden	Norra Mellansverige (N. Middle Sweden)	1.359	1.72	-0.36	0.181
Sweden	Mellersta Norrland (Middle Norrland)	1.544	1.61	-0.07	0.132
UK	North East	1.398	0.86	0.52	0.101
UK	North West	1.287	1.05	0.23	0.091
UK	Yorkshire & the Humber	1.431	0.99	0.43	0.106
UK	East Midlands	1.431	0.87	0.55	0.097
UK	West Midlands	1.297	0.93	0.361	0.125
UK	East England	2.813	1.03	1.78	0.097
UK	London	1.432	1.00	0.42	0.212
UK	South West	1.098	1.16	-0.06	0.108
UK	Wales	1.497	1.07	0.42	0.107
UK	Scotland	1.472	1.05	0.42	0.113
UK	Northern Ireland	1.457	1.03	0.42	0.094

Table A3.3. Determinants of support for compensation, 2002-2006: double interactions.

	1	2
	Import exposure*Regional Imports	Import exposure*Specialisation
Import exposure	0.0530 (0.0945)	-0.1162 (0.1447)
Regional Imports	0.3715 (0.2486)	
Import exp*Regional imports	-0.0059 (0.0229)	
Specialisation		-2.0065 (1.7682)
Import exposure*specialisation		1.6903 (1.2635)
Regional exports	-0.1527* (0.0824)	
Export exposure	-0.4694** (0.2240)	-0.2168** (0.0734)
Employment in industry	0.0199 (0.0179)	0.0194 (0.0219)
Regional capita GDP	-0.0005 (0.0009)	-0.0013 (0.0008)
Regional social expenditure	0.0012** (0.0003)	0.0011** (0.0002)
Income	-0.0574** (0.0136)	-0.0608** (0.0127)
Lower secondary	0.0747 (0.1187)	0.0179 (0.1061)
Upper secondary	-0.2097* (0.1093)	-0.2073** (0.0984)
Post-secondary	-0.5709** (0.2337)	-0.6003** (0.2026)
Tertiary	-0.8086** (0.1333)	-0.7620** (0.1184)
Age	0.0007* (0.0004)	0.0005 (0.0004)
Gender	0.3411** (0.0656)	0.3167** (0.0600)
Union	0.3701** (0.0665)	0.3674** (0.0608)
Attendance	-0.0065 (0.0245)	-0.0118 (0.0225)
Denomination	0.0023 (0.0764)	-0.0093 (0.0710)
High general skills	-0.2323** (0.0931)	-0.2965** (0.0855)
Specific skills	0.1872** (0.0818)	0.1155 (0.0754)
Constant	0.6320 (0.5687)	0.9986 (0.6812)
Observations	6522	7798

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Table A3.4. Robustness checks: volume of trade, regional unemployment, individual unemployment and regional value added.

	1	2	3	4
	Trade volume		Regional Unemployment	
	Competitive	Uncompetitive	Competitive	Uncompetitive
Trade volume	-0.3511** (0.1384)	-0.0030 (0.3753)		
Specialisation	-5.7985** (2.1928)	0.8656 (4.6716)	-5.3568** (1.9931)	1.4784 (4.0473)
Trade*Spec.	2.9101** (1.2564)	0.0104 (3.0054)		
Regional unemp			0.0213 (0.0216)	0.0089 (0.0470)
Unemployed				
Import exposure			-0.5209** (0.2221)	0.2369 (0.5926)
Import*Spec.			4.8835** (1.9819)	-0.9883 (4.6654)
Export exposure			-0.1253 (0.0984)	-0.2117 (0.1548)
Regional exports	-0.2785** (0.0825)	-0.0560 (0.4510)	-0.2577** (0.0825)	-0.0099 (0.4460)
Employment industry	-0.0167 (0.0179)	0.0657 (0.0454)	-0.0239 (0.0186)	0.0620 (0.0489)
Reg. cap GDP	0.0005 (0.0010)	-0.0007 (0.0017)	0.0001 (0.0010)	-0.0006 (0.0017)
Reg. Soc. Exp.	0.0001 (0.0003)	0.0017** (0.0004)	-0.0002 (0.0005)	0.0016* (0.0009)
Income	-0.0614** (0.0163)	-0.0447* (0.0248)	-0.0604** (0.0163)	-0.0428* (0.0249)
Lower secondary	0.2263 (0.1661)	-0.1934 (0.1723)	0.2289 (0.1666)	-0.1917 (0.1723)
Upper secondary	-0.1578 (0.1539)	-0.3560** (0.1575)	-0.1519 (0.1544)	-0.3442** (0.1580)
Post-secondary	-0.0779 (0.3790)	-0.9306** (0.3051)	-0.0897 (0.3804)	-0.9391** (0.3050)
Tertiary	-0.8700** (0.1859)	-0.8598** (0.1926)	-0.8559** (0.1863)	-0.8426** (0.1933)
Age	0.0007 (0.0005)	0.0006 (0.0008)	0.0008 (0.0005)	0.0006 (0.0008)
Gender	0.3496** (0.0838)	0.3538** (0.1039)	0.3421** (0.0843)	0.3278** (0.1053)
Union	0.2520** (0.0841)	0.4914** (0.1075)	0.2592** (0.0843)	0.5059** (0.1082)
Attendance	-0.0305 (0.0318)	0.0193 (0.0386)	-0.0333 (0.0318)	0.0167 (0.0387)
Denomination	0.1572 (0.1044)	-0.1520 (0.1126)	0.1581 (0.1045)	-0.1521 (0.1124)
High general	-0.1494 (0.1213)	-0.3923** (0.1454)	-0.1392 (0.1215)	-0.3888** (0.1455)
Specific	0.2642** (0.1052)	0.0587 (0.1299)	0.2637** (0.1052)	0.0416 (0.1305)
Constant	3.0429** (0.6572)	-0.8524 (1.5626)	3.1975** (0.6581)	-0.8521 (1.5783)
Observations	3865	2657	3865	2657

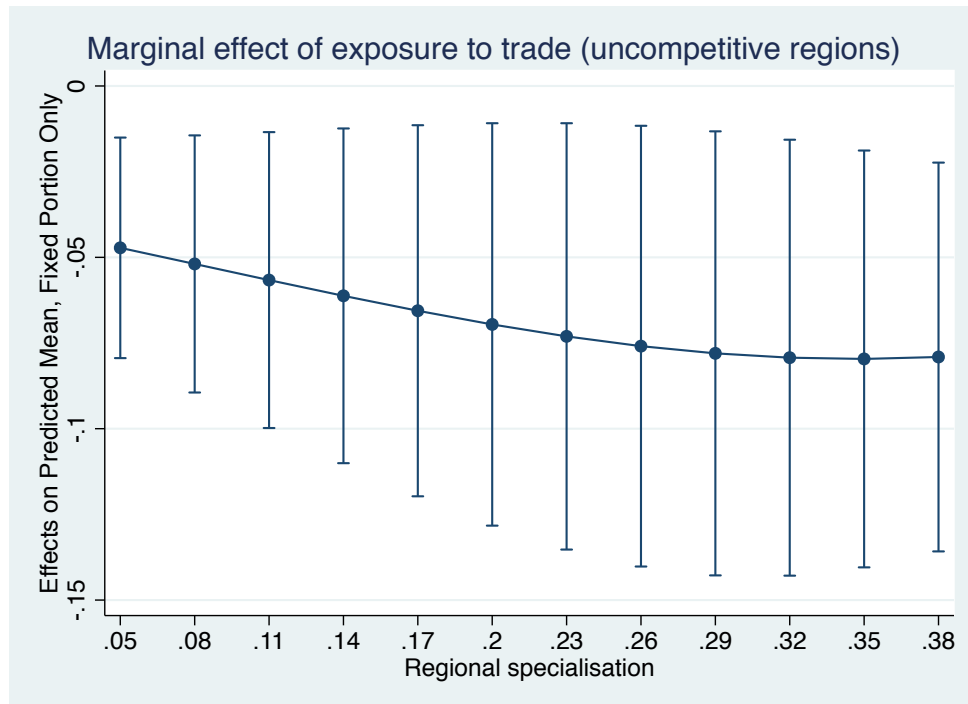
Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Table A3.4. (Continued)

	5	6	7	8
	Unemployment status		Regional value added growth	
	Competitive	Uncompetitive	High VA	Low VA
Trade volume				
Specialisation	-5.2542** (1.9922)	1.4298 (4.0485)	-2.4013 (3.5569)	-1.9699 (2.5932)
Trade*Spec.				
Regional unemp				
Unemployed	0.3001 (0.2048)	0.0879 (0.2517)		
Import exposure	-0.5107** (0.2219)	0.2347 (0.5927)	-0.0637 (0.4562)	-0.4752* (0.2435)
Import*Spec.	4.8389** (1.9831)	-0.9744 (4.6663)	1.4609 (3.6506)	4.4852** (2.1528)
Export exposure	-0.1330 (0.0984)	-0.2116 (0.1546)	-0.2108 (0.1335)	-0.1190 (0.1063)
Regional exports	-0.2814** (0.0813)	-0.0129 (0.4463)	-0.0916 (0.2369)	-0.1527 (0.1040)
Employment industry	-0.0166 (0.0176)	0.0656 (0.0451)	0.0070 (0.0295)	0.0238 (0.0219)
Reg. cap GDP	0.0005 (0.0010)	-0.0006 (0.0017)	-0.0001 (0.0015)	-0.0019 (0.0013)
Reg. Soc. Exp.	0.0001 (0.0003)	0.0017** (0.0004)	0.0009** (0.0004)	0.0013** (0.0003)
Income	-0.0608** (0.0163)	-0.0424* (0.0250)	-0.0553** (0.0194)	-0.0590** (0.0193)
Lower secondary	0.2389 (0.1663)	-0.1920 (0.1723)	-0.1322 (0.1998)	0.1562 (0.1503)
Upper secondary	-0.1420 (0.1542)	-0.3451** (0.1580)	-0.4221** (0.1844)	-0.1155 (0.1389)
Post-secondary	-0.0742 (0.3792)	-0.9397** (0.3050)	-0.6961* (0.3925)	-0.5185* (0.2924)
Tertiary	-0.8512** (0.1864)	-0.8444** (0.1934)	-0.7586** (0.2192)	-0.8985** (0.1720)
Age	0.0008 (0.0005)	0.0006 (0.0008)	0.0009* (0.0005)	0.0003 (0.0007)
Gender	0.3376** (0.0843)	0.3281** (0.1054)	0.3571** (0.0969)	0.3215** (0.0898)
Union	0.2627** (0.0844)	0.5066** (0.1082)	0.3228** (0.0974)	0.3936** (0.0922)
Attendance	-0.0316 (0.0319)	0.0175 (0.0386)	0.0082 (0.0372)	-0.0153 (0.0328)
Denomination	0.1627 (0.1046)	-0.1510 (0.1125)	-0.0060 (0.1138)	0.0187 (0.1037)
High general	-0.1340 (0.1217)	-0.3870** (0.1457)	-0.3427** (0.1422)	-0.1574 (0.1249)
Specific	0.2657** (0.1053)	0.0417 (0.1305)	0.1130 (0.1229)	0.2154* (0.1108)
Constant	3.0021** (0.6430)	-0.9423 (1.5247)	1.4966* (0.8829)	0.8934 (0.7904)
Observations	3865	2657	3008	3514

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Figure A3.4. Marginal effect of exposure to trade (sector imports plus exports over sector value added)



The relationship between geography, institutions and compensation:

Testing the macro-level implications

The argument outlined in Chapter 2 posits that compensation outcomes are the product of demand stemming from the map of regional preferences in a given country and the supply of policy related to a given set of institutional mechanisms. Levels of competitiveness and levels of regional specialization shape demand for compensation. Although in expectation some workers lose from trade more than others, there may be mechanisms linked to geography by which their interests may not be harmed significantly when faced with increased foreign competition. Chapter 3 shows that the preferences of losing factors hypothesised in the theory are fairly accurate. The analysis of survey data shows that regional specialization and competitiveness jointly shape preferences for policy. Individuals facing greater imports in specialized uncompetitive regions tend to support higher levels of compensation than similar individuals in diversified regions.

This chapter turns to the task of systematically confronting some of the macro-level empirical implications stemming from the model. It addresses the question of how institutional arrangements translate preferences into policy outcomes. A first aim of this analysis is to determine the extent to which electoral systems respond to the preferences stemming from a given map of regional interests. The argument outlined in the theoretical chapter has a number of empirical implications for how electoral institutions translate into higher or lower levels of policy under different constellations of regional interests. It predicts that when trade losers are geographically concentrated, systems with

low district magnitude and plurality rules translate into higher levels of compensation than high-magnitude PR systems. When trade losers are geographically dispersed, systems with high district magnitude and proportional rules and low district magnitude and plurality will exhibit no significant differences in spending, all else equal.

A second aim of the analysis is to put to the test some of the key implications on the role of bicameralism stemming from the argument developed in Chapter 2. The argument emphasizes that the presence of a strong upper chamber in bicameral systems generates institutional veto players with incentives to respond to particular interests. This has implications for the level of compensation as well as for the relative effect of electoral institutions. In expectation, the presence of an upper house with legislative authority should lead to lower levels of compensation relative to where the former does not exist, across electoral rules. This also means that electoral rules matter less for policy outcomes, which are driven to a larger extent by veto bargaining between legislative bodies.

The analysis developed below has some caveats. The argument in Chapter 2 has implications for patterns of compensation within countries that cannot be easily tested cross-nationally. Specifically, the presence of a strong upper chamber dampens levels of compensation where regional veto players in the upper house prefer lower levels of policy. Given the lack of cross-national data on the preferences of regional veto players in the upper house, however, this chapter focuses on the first implication and tests whether the effect of electoral institutions differs across countries with greater or lesser regional legislative authority. Testing whether the presence of a strong upper house shapes levels of policy is left for later chapters.

The chapter proceeds in three stages. A first section focuses on the effect of electoral institutions on compensation. It summarizes the key predictions stemming from the

argument, discusses measurement of the dependent and independent variables used in the analysis, and outlines the model specification. It then tests the argument using a panel of European countries between 1980 and 2010, and presents the findings. A second section focuses on the heterogeneous effect of electoral institutions depending on levels of regional authority. It reviews the main elements of the argument, discusses measurement challenges associated with testing the argument and subsequently tests the argument in the panel of European countries. Lastly, a third section concludes and discusses the findings in the framework of the theoretical argument.

4.1 The effect of electoral institutions on compensation

4.1.1 Hypotheses

Chapter 2 emphasized that the effect of electoral institutions on policy is contingent on the geographical concentration of trade losers. Policymakers under plurality have incentives to target policy to voters in geographically defined districts (Persson and Tabellini 2000, 2003). Because trade losers in specialized and uncompetitive regions face substantially higher levels of labour market risk, voters in such districts demand greater levels of policy. In turn, those in specialized competitive regions face some risk associated with specialization, but benefit from greater levels of competitiveness. On average, however, trade losers in specialized regions across levels of competitiveness should thus demand relatively high levels of compensation. In the presence of high demanders, plurality should lead to higher levels of compensation.

In contrast, under high-magnitude and proportional rules policymakers have lesser incentives to target trade losers that are geographically concentrated, competitive or not. Policymakers in systems with high district magnitude are dependent on the national vote share to win reelection and are thus less likely to focus on particular constituents. Even

if trade losers concentrated in uncompetitive regions demand relatively greater compensation, catering to such interests is unlikely to secure re-election, as the electoral gains of targeting trade losers are concentrated in a few districts.

Finally, policymakers elected under proportional rules in systems with high district magnitude have incentives to cater to geographically dispersed voters because winning the election requires maximizing the national vote share (Persson and Tabellini 2000, McGillivray 2004). This comprises trade losers in diversified regions, competitive or uncompetitive. However, when demand for compensation is low, as among losing interests in uncompetitive diversified regions, even politicians in systems with high magnitude will have lesser incentives to increase compensation. Where trade losers are dispersed, low demand for compensation dampens the supply of compensation by policymakers in high magnitude systems, who would otherwise be expected to increase spending. Note that this is similar to the expected outcome in majoritarian systems. Where trade losers are geographically dispersed, politicians in systems with low magnitude and plurality have lesser incentives to increase spending, as distributing benefits without discriminating geographically will not increase their electoral rewards. The absence of high demanders further dampens incentives to increase policy. This implies that there should be no significant differences in generosity between governments elected under different rules in contexts where trade losers are geographically dispersed.

In sum, when trade losers are geographically concentrated, policymakers in systems with low district magnitude and plurality rule are expected to cater to the interests of trade losers to a greater extent than under PR and higher magnitude. When trade losers are geographically dispersed, policymakers under PR and higher magnitude and

plurality-lower magnitude are not expected to exhibit significant differences in spending, all else equal.

4.1.2 Dependent and independent variables

The dependent variables

Compensation in the context of trade openness fundamentally comprises measures of income support in the event of income loss. Analytically, income loss comprises situations of lower wages as a result of trade, including formal or informal employment and unemployment. The analysis mainly focuses on social policy instruments that address these situations, such as unemployment benefits and active labour market policies. Using such measures of spending makes it possible to engage with arguments that posit that spending under an open economy is fundamentally constrained. A prominent literature argues that increasing trade and capital openness have constrained governments' use of fiscal policies associated with demand management (Alt 1985, Frieden 1992, Scharpf 2000). To the extent that active labour market programmes constitute fiscal policies designed to foster (full) employment, providing evidence of a relationship between trade and a number of such policies constitutes somewhat of a hard test.⁷¹ Given alternative measures used in the literature, the analysis is also replicated using a measure of industrial subsidies as a further test (Rickard 2012, 2012b, Etchemendy 2011).

A first dependent variable is a measure of unemployment benefit generosity. Numerous studies testing the effect of trade on the welfare state rely on measures of resources (social spending as a % of GDP) (Huber and Stephens 2001, Garrett 1998, Busemeyer 2009, Rickard 2012a). While such measures are useful to capture the size of the welfare

⁷¹ Some scholars argue that ALMPs constitute supply policies (Boix 1998).

effort, they say little about how generous spending is relative to the pool of beneficiaries, and arguably do not take into account changes in societal welfare needs. Resource measures incorporate the effect of automatic adjustment through stabilizers (for instance, in the case of unemployment benefits), making it difficult to account for political decisions beyond automatic adjustment. The analysis below relies on a measure of benefit generosity as the ratio of spending on unemployment benefits (in million EUR) over the number of unemployed in the civilian labour force. Data were taken from the OECD's social expenditure (aggregated data) database. Spending on unemployment comprises all cash expenditures to individuals compensating for unemployment, and includes redundancy payments out of public resources as well as pensions to beneficiaries before they reach retirement age if these payments are made because they are out of work or for reasons of labour market policy (OECD 2003).

A second dependent variable is a measure of generosity of active labour market policies (ALMP). The measure comprises expenditure items aimed to improve an individual's chances of finding employment, and was constructed on the basis of selected categories of ALMP provided by the OECD. The latter include spending on public employment services and administration, employment subsidies, job rotation schemes, start-up incentives, direct job creation and labour market training. The measure excludes the category of labour market programmes for the disabled, and thus better approximates the labour market dimension of compensation. Like above, it is computed as the ratio of spending on selected categories and the number of unemployed. Logs across both measures were taken to compress the distribution.⁷² Additional analyses were carried out using resource measures of unemployment benefits and subsidies (both measuring spending as % of GDP) to facilitate comparison with existing research.

⁷² Testing for normality of residuals across both DVs shows that the distribution of residuals has a strong positive skew.

The independent variables

The argument outlined in Chapter 2 implies that compensation outcomes should vary according to the effect of international competition on individuals, by level of regional specialization and by electoral system.⁷³

One of the main explanatory variables, exposure to international competition, is captured using a measure of imports of goods and services as a % of GDP. *Imports* captures the bulk of manufacturing which has traditionally been most exposed to foreign competition. A second measure, *Trade volume* (imports plus exports as a share of GDP), is included in the analysis. For the purposes of the argument, measures of trade volume are likely to conflate the effects of imports and exports, which may not go in the same direction. However, the analysis includes a measure of trade volume as an additional test to facilitate direct comparisons with existing research.⁷⁴ All indicators are taken from the OECD.

The second main explanatory variable is captured using an indicator of geographical concentration for the manufacturing industry. Cambridge Econometrics provides disaggregated data on regional employment in the manufacturing sector over the time period 1980-2010. Data were used to compute a Herfindahl-Hirschmann Index of geographical concentration for manufacturing. The manufacturing sector includes sectors C, D and E of the NACE Rev 1.1 classification, which correspond to mining and quarrying, manufacturing and energy, respectively.⁷⁵ The index was computed for the

⁷³ Research suggests that the argument should be applicable to capital inflows. Because factor flows can be a perfect substitute for trade in commodities in the standard Heckscher-Ohlin model, capital inflows and imports may have similar effects on domestic labour (Mundell 1957, cited in Rickard 2006: 14).

⁷⁴ Cameron (1978), Burgoon (2001), Huber and Stephens (2001), Rodrik (1997), Rudra and Haggard (2005).

⁷⁵ Unfortunately, it was not possible to disaggregate by sub-sector. Alternative indicators on imports and exports were made consistent with the scope of the geographical concentration measure by computing the volume of imports and that of exports for a number of sub-sectors as classified in the SITC. Results for the broader measure are presented here.

manufacturing industry across regions in a country, for all years, and normalized to take into account the different number of regions across countries.⁷⁶ It compares the distribution of employment in one industry with a uniform distribution in which employment is equally spread across all regions in a country.⁷⁷ The value of the index reaches an upper bound of 1 when all employment in industry is concentrated in one region, and takes the lowest value $1/R$ (where R is the number of regions), when industry employment is evenly distributed across all regions.

This measure speaks to important theoretical concerns outlined in the argument. At low scores on the concentration index, employment in manufacturing in a given country will be uniformly spread across all regions in a country.⁷⁸ This implies that demand for compensation will be equally distributed among a highly exposed sector – manufacturing – in the economy.⁷⁹ According to the argument in Chapter 2, policymakers elected under plurality are unlikely to deliver increased compensation in such settings. Not only is demand for compensation dampened at lower levels of concentration, but the geographical spread of import-exposed sectors makes it difficult to select particular districts to obtain political support. In the sample of 14 countries, the

⁷⁶ The Nomenclature of Territorial Units for Statistics (NUTS) classifies administrative divisions of European countries for statistical purposes, and may have different levels. Germany has 39 NUTS2 regions, Greece has 13 NUTS2 regions, Spain has 17 NUTS2 regions, France has 22 NUTS2 regions, Ireland has 8 NUTS3 regions, Italy has 21 NUTS2 regions, Belgium has 11 NUTS2 regions, Denmark has 11 NUTS3 regions, the Netherlands has 11 NUTS2 regions, Austria has 9 NUTS2 regions, Finland has 20 NUTS3 regions, Sweden has 8 NUTS2 regions, the UK has 37 NUTS2 regions and Portugal has 5 NUTS2 regions.

⁷⁷ It is given by the following expression: $HHI_i = \sum S_r^2$ where S is the share of industry employment in region r .

⁷⁸ This closely echoes research by Rickard (2012b), who tests the conditional effect of geographical concentration on the relationships between electoral institutions and the provision of narrow spending. While the data is also taken from Cambridge Econometrics, the concentration measure used in Rickard (2012b) is an entropy index capturing the “degree of a sector’s employment concentration relative to the geographic distribution of aggregate employment” (Rickard 2012b: 864).

⁷⁹ Other measures of geographical concentration take as their baseline total employment – for instance, the locational Gini. Low scores on this index would imply that manufacturing employment is geographically spread proportional to total employment. Thus, demand for compensation from the manufacturing sector would be no greater (or less) than from any other sector(s) in a given geographic location. For this argument, however, this makes no little difference. Even if low values on the HHI mean that manufacturing is equally spread out but the remaining (total) employment is unequally distributed, what matters in the context of trade-induced compensation is the distribution of the exposed sector (manufacturing).

minimum value of concentration is 0.009 (Germany 2010) and the maximum is 0.38 (Greece 1980). As will be shown below, the measure changes over time, albeit slowly.⁸⁰ By construction, however, the geographical concentration measure is unlikely to capture highly specialized scenarios, since the level at which the data is aggregated (NUTS2 or NUTS3) is too high to capture extreme situations of one region-one industry.

Electoral institutions are the third key explanatory variable. A measure of district magnitude is used to capture the extent to which institutions cater to broader interests. The measure captures the substantial variation that exists within the universe of PR countries. Most European countries in the sample have PR rules (11 out of 14), limiting the sample of those with majoritarian institutions to 3.⁸¹ Given the low variation in electoral formula in the sample under study, this measure is preferable to binary indicators for PR and plurality.

The coding of Germany deserves a little more attention. According to the Bormann and Golder measure of district magnitude, the mixed PR system in Germany has a district magnitude of 1. This may reflect the fact that it is a mixed electoral system where voters have two votes, one for a candidate in a single-member district (first vote) and for party lists (second vote). The second vote ensures a fairly proportional link between votes and seats. Since the theoretical argument on the effect of electoral institutions has generally considered pure cases, there may be some ambiguity on how to treat mixed cases such as Germany. The coding of district magnitude in the Bormann and Golder data may capture incentives of individual legislators to serve their districts, but there may be countervailing incentives based on second vote-induced proportionality. To address this,

⁸⁰ Graphs show substantial variation within and across countries over time.

⁸¹ France, Germany and the UK are coded as having majoritarian institutions, (although PR was used in the 1986 and 1987 elections in France). Greece resorted to a mixed-member system (coded as majoritarian) during the period 2007-2010, while Italy also went back and forth between PR and a mixed-member system (PR during 1980-1993, mixed member 1994-2005, PR 2006-2010).

the analysis is run excluding Germany, and as will be shown below, the findings are robust to its exclusion. The variable is a continuous measure that allows for greater nuance of changes over time, and is taken from the Bormann and Golder dataset (2013). The measure is particularly useful because it offers a classification of electoral systems based on substantively relevant criteria and allows for within country changes over time. It is calculated as the total number of seats allocated in an electoral tier divided by the total number of districts in that tier. It ranges from a minimum value of 1 (the United Kingdom) and 150 (the Netherlands).

Control variables

Several other variables are included in the analysis. *Industry GVA* is a measure of the net output of a country's industry after adding up all outputs and subtracting intermediate inputs.⁸² It is thus a country-level measure. Industry includes manufacturing, coal and mining activities, and energy. Including this variable is important because an increase in imports may not necessarily imply a loss of competitiveness, but may also signal a heightened level of activity – implying sector growth, but also increased trade and including imports. Substantively, this makes it possible to conclude that increases in imports lead to greater compensation holding constant the level of output. Since imports and exports in a given country are highly correlated, a measure of exports (% GDP) is also included to minimize omitted variable bias (Rickard 2012: 1178).

In addition, a number of standard control variables used in the literature are included. Given the temporal scope of the analysis, varying levels of economic development in

⁸² The measure is taken from the WDI, where industry corresponds to ISIC divisions 10-45, and includes manufacturing (ISIC divisions 15-37), coal and mining activities and gas, electricity and water (energy). This measure is used instead of a measure of manufacturing value added to make it consistent with the *Geographical concentration* variable, which employs a definition of manufacturing that includes manufacturing, mining and gas. The industry measure is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources.

earlier periods may constrain the provision of compensation (Wibbels 2006). As will be illustrated in Chapter 6, countries undergoing political transition such as Spain (or Portugal) had very low levels of welfare spending in the early 1980s. Including GDP per capita controls for the possibility that varying levels of development may drive levels of spending. Relatedly, including GDP per capita also makes it possible to compare countries with similar levels of development, as it “accounts for the possibility that wealthier countries may be less sensitive to the income effects of trade because they are better able to self-insure against income loss” (Rickard 2012: 1176).

A measure of union density is included to control for the possibility that labour market institutions have a positive effect on spending. A large literature in comparative politics argues that labour market institutions affect welfare spending in the context of increased trade (Garrett 1998). The analysis does not address whether labour market institutions affect policy. Once controlled for, the expectation is that geographical concentration and institutions account for whether trade exposure shapes policy or not. A measure of employment in industry is included to control for the possibility that de-industrialization is driving changes in compensation (Iversen and Cusack 2000). Moreover, following Rickard (2012b: 867), including this variable addresses concerns that the number of people employed in industry may influence both levels of spending as well as and the geographic distribution of sector employees. It is measured as the share of civilian employment in industry (manufacturing and energy) as a % of total civilian employment. Data is taken from the OECD for all countries. A variable for the share of the population aged between 15-64 controls for the potential effect of the size of the work force on the amount of spending. A variable measuring the rate of unemployment (as % of civilian labour force) is also included.

Finally, prominent arguments stress that left governments are more likely to promote greater levels of welfare spending (Garrett 1998, Huber and Stephens 2001) and ALMP (Huo, Nelson and Stephens 2008). However, Rueda (2007) argues that left governments have few incentives to represent the interests of the unemployed. To control for the potential effect of partisanship on compensation, the analysis includes a variable measuring social democratic and other left-wing parties in the cabinet as a percentage of total cabinet posts, weighted by the number of days the government was in office in a given year. Data were taken from the Comparative Political Dataset (2012). As emphasized by Rickard (2012b: 867), given the theorized effect of electoral rules, controlling for ideology is relevant because left governments tend to be associated with PR (Iversen and Soskice 2006).

The analysis tests whether the effect of increased greater trade on spending among those that stand to lose from trade is conditional on geographical concentration using annual data from 14 European countries from 1980 to 2010. The countries for which data are available mostly depend on the *Geographical concentration* variable, which is limited to a sample of European countries for the period 1980-2010. They include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Ireland, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. Data for active labour market policies is available for all countries from 1985 to 2010.⁸³ Data for unemployment benefits is available for all countries for the 1980-2010 period.

Before proceeding to the statistical analysis, Table 4.1 shows levels of unemployment generosity (as % of GDP) for all countries from 1980 to 2010. Dividing the sample into three groups makes it possible to better appreciate cross-national variation. A distinction is made between low, intermediate and high levels of generosity according to whether

⁸³ Some countries have observations for the 1980-1985 period.

average values over the period fall below the 30th percentile, between the 30th and the 60th percentile and above the 60th percentile.⁸⁴ A first group comprises countries with low levels of unemployment benefit generosity. Belgium, Italy, Greece, Portugal and the UK devote low levels of benefits in relation to the needs of their population. Within this group, Greece is least generous (7.3), while Belgium is the most generous (8.6). A second group comprises generous countries that devote relatively large amounts of benefits, and includes Austria, Denmark, the Netherlands and Sweden. Among these, Denmark is most generous (10.4) and Sweden is least generous (9.4). A last group of countries lies in between these two poles, and comprises Finland, France, Germany, Ireland and Spain, with Finland and Ireland displaying highest levels of generosity (9.3) and Spain the lowest (8.6).

Table 4.1 Unemployment generosity in Europe, 1980-2010

Country	1980	1985	1990	1995	2000	2005	2009	Average	Level
Austria	9.2	9.3	9.5	9.7	9.6	9.5	9.5	9.6	High
Belgium	7.4	7.9	8.4	8.4	8.8	8.9	8.9	8.6	Low
Denmark	10.4	10.2	10.1	10.5	10.7	10.6	10.2	10.4	High
Finland	8.4	9.1	9.6	9.3	9.4	9.6	9.6	9.3	Med
France	0	9.4	9.3	9.1	9.2	9.4	9.2	9.2	Med
Germany	8.9	8.7	9.2	9.2	9.1	9.1	9.4	9.1	Med
Greece	7.9	7.1	7.5	7.2	7.1	7.4	8.1	7.3	Low
Ireland	.	8.9	9.0	9.3	9.4	9.6	9.6	9.3	Med
Italy	8.1	8.6	7.8	8.1	7.7	8.2	8.6	8.2	Low
Netherlands	9.5	9.7	9.7	9.9	10.2	9.9	10.2	9.9	High
Portugal	6.5	6.4	7.3	8.1	8.4	8.5	8.1	7.6	Low
Spain	8.6	8.4	8.9	8.5	8.6	9.1	8.9	8.6	Med
Sweden	9.3	9.8	10.2	9.4	9.6	9.2	8.3	9.4	High
UK	9.1	8.9	8.2	8.2	8.1	8.1	7.8	8.4	Low

Table 4.1 also reveals a number of patterns within countries over time. A number of countries in the sample exhibit upward trends in benefit generosity throughout the period. This is the case of Belgium, Denmark, Ireland, the Netherlands, Portugal and

⁸⁴ To calculate the cut-off points, I first computed the average for each country for the 30 years over the 1980-2010 period.

Spain. The UK comes closest to exhibiting a systematic decrease throughout the period, while Sweden also shows a mostly downward trend. Countries with stable or no clear pattern are Austria, Finland, France, Germany, Greece and Italy.

Table 4.2 Generosity of active labour market policies in Europe, 1980-2010

Country	1980	1985	1990	1995	2000	2005	2009	Average	Level
Austria	.	7.72	8.17	8.35	8.9	8.9	9.29	8.53	Med
Belgium	.	7.84	8.37	8.31	9.02	8.9	9.33	8.58	High
Denmark	7.55	8.38	9.86	11.34	11.92	11.68	11.38	10.46	High
Finland	7.7	8	9.03	8.1	8.35	8.66	8.76	8.37	Med
France	.	.	.	.	.	.	.	.	
Germany	.	7.53	8.79	8.72	8.91	8.24	8.87	8.62	High
Greece	.	4.53	5.64	6.73	6.41	5.46	7.02	6	Low
Ireland	.	7.08	7.72	8.3	9.25	9.27	8.51	8.42	Med
Italy	.	.	6.37	6.86	7.9	8.36	8.14	7.65	Low
Netherlands	5.97	7.64	8.03	8.49	9.73	9.17	9.5	8.36	Med
Portugal	.	.	6.93	7.04	8.19	7.74	7.75	7.25	Low
Spain	4.69	5.22	6.87	6.19	7.56	8.18	7.65	6.67	Low
Sweden	.	11.63	12.3	11.32	11.78	11.32	11.13	11.66	High
UK	7.05	7.01	7.69	7.44	7.6	8.59	7.87	7.57	Low

Table 4.2 shows patterns of generosity of active labour market policies.⁸⁵ The UK, Greece, Italy, Portugal and Spain exhibit low levels of generosity, with Greece being least generous. A second group denotes countries with high levels of generosity, and comprises Denmark, Germany, Sweden and to a lesser extent, Belgium. Sweden is most generous, and Belgium is arguably at the margin. Lastly, countries such as Austria, Finland, Ireland and the Netherlands lie in between, with Austria displaying highest levels of generosity and the Netherlands the lowest. Temporal variation is also discernible. Countries such as Austria and Finland exhibit upward trends throughout the period. Many countries follow an upward trend until the 2000s and then experience a slight decrease. Such is the case of Denmark, Ireland, Italy, Netherlands, Portugal, Spain

⁸⁵ Data is not available for France.

and the UK. In contrast, countries such as Belgium, Germany, Greece, and Sweden show no clear pattern.

Table 4.3 illustrates levels of geographical concentration for the sample of countries across the same time period. “Low” levels of concentration comprise countries that fall under the 30th percentile, and include Denmark, France, Germany, Sweden and the UK. Among this group, Sweden offers the highest levels of concentration, while Germany exhibits the lowest levels. Moderately concentrated countries are those that fall between the 30th and the 60th percentile, and include Austria, Belgium, Finland, Ireland and the Netherlands. Austria is the country with the highest levels of concentration among them, whereas Finland exhibits the lowest level of concentration. Lastly, highly concentrated countries are those with values between the 60th and the 90th percentile, and include Greece, Italy, Portugal and Spain.

Table 4.3 Geographical concentration of manufacturing in Europe, 1980-2010

Country	1980	1985	1990	1995	2000	2005	2010	Average	Level
Austria	0.051	0.049	0.046	0.044	0.044	0.044	0.044	0.046	Med
Belgium	0.041	0.041	0.044	0.041	0.041	0.042	0.040	0.042	Med
Denmark	0.027	0.027	0.029	0.03	0.032	0.030	0.039	0.031	Low
Finland	0.042	0.053	0.048	0.042	0.045	0.043	0.043	0.046	Med
France	0.037	0.036	0.035	0.025	0.022	0.021	0.02	0.028	Low
Germany	0.014	0.013	0.012	0.009	0.01	0.009	0.009	0.011	Low
Greece	0.373	0.346	0.294	0.271	0.162	0.153	0.15	0.252	High
Ireland	0.057	0.042	0.043	0.038	0.028	0.021	0.022	0.035	Med
Italy	0.082	0.075	0.076	0.074	0.07	0.074	0.071	0.074	High
Netherlands	0.035	0.037	0.042	0.043	0.044	0.043	0.046	0.042	Med
Portugal	0.128	0.143	0.19	0.178	0.18	0.179	0.177	0.169	High
Spain	0.067	0.063	0.07	0.067	0.071	0.065	0.061	0.067	High
Sweden	0.03	0.03	0.03	0.031	0.033	0.034	0.035	0.032	Low
UK	0.015	0.016	0.015	0.015	0.014	0.013	0.012	0.014	Low

In general, geographical concentration varies over time, albeit slowly. However, a number of patterns stand out. A first group of countries exhibits a fairly stable pattern over the period: Belgium, Italy, Austria and Germany (with the latter two showing a

slump at first). A second group of countries exhibits secular decrease over the period, such as France, Greece, Ireland and the UK. Lastly, countries such as Denmark, the Netherlands and Sweden exhibit systematic increases over time. Lastly, Finland, Portugal and Spain exhibit no clear pattern, with some highs and lows throughout the period.

Table 4.4 Imports (% GDP) in European countries, 1980-2010

Country	1980	1985	1990	1995	2000	2005	2010	Average	Level
Austria	36.2	36.2	36.8	35.7	44.4	49.8	50.0	40.2	High
Belgium	57.7	67.1	65.3	61.4	75.2	74.7	77.7	67.3	High
Denmark	34.8	37.6	32.5	33.4	40.4	44.1	44.7	37.6	High
Finland	32.5	27.7	24.1	28.9	34.4	37.6	39.0	30.8	Med
France	22.9	24.2	22.3	21.4	27.8	26.9	27.79	24.1	Low
Germany	25.1	26.9	24.8	23.1	33.1	36.1	42.0	28.9	Med
Greece	30.4	29.2	30.6	27.3	39.6	32.4	31.5	31.4	Med
Ireland	59.1	54.7	51.2	63.7	84.1	69.5	82.0	63.6	High
Italy	23.7	22.4	18.8	21.8	25.8	25.9	28.5	22.5	Low
Netherlands	52.4	57.9	52.6	53.6	64.5	61.1	70.6	56.7	High
Portugal	33.5	33.1	36.7	33.8	39.9	37.1	39.0	35.7	Med
Spain	16.8	19.5	19.3	22.3	32.2	30.9	29.5	24.1	Low
Sweden	30.9	33.6	29.7	32.9	40.1	40.6	43.2	34.9	Med
UK	24.6	27.3	25.9	27.8	29.1	29.4	32.3	27.4	Low

Table 4.4 shows data for imports (% GDP). Unsurprisingly, those countries with high levels of imports (with values above 36%) are the small economies: Austria, Belgium, Denmark, Ireland and the Netherlands. Among them, Belgium exhibits the highest level over the period (67%), while Denmark exhibits levels that are closer to the cut-off point (37%). Countries with intermediate levels of imports (between 28% and 36%) are Finland, Germany, Greece, Portugal and Sweden. Among these countries, Portugal exhibits relatively high levels of imports (almost 36%) while Germany offers a lower bound of 28%. Finally, countries with relatively low levels of imports constitute those with values beneath the 30th percentile (28%) and include France, Italy, Spain and the

UK. Among them, Italy exhibits the lowest levels of imports (22%) while the UK exhibits the highest among them (27%).

A glimpse at variation over time also reveals a number of patterns. Firstly, most countries experience an increase in imports at the end of the 1990s.⁸⁶ Secondly, a number of distinct patterns stand out. Most countries exhibit unstable patterns of imports from 1980 to 1995. However, some countries experience an increase in imports after 2000 (Austria, Belgium, Denmark, Finland, Germany, Italy, Sweden and the UK). Others exhibit decreases in imports (Greece and Spain). Finally, other countries seem to not exhibit a clear pattern (the Netherlands, Ireland and Portugal).

Table 4.5 shows the relatively wide variation in district magnitude in the sample of countries. To recall, the measure of district magnitude is a continuous measure taken from Bormann and Golder (2013). Relative to a binary indicator, the continuous measure allows for greater nuance of changes over time, and is calculated as the total number of seats allocated in an electoral tier (the first tier) divided by the total number of districts in that tier. It ranges from a minimum value of 1 (the United Kingdom) and 150 (the Netherlands). Like above, country averages for the 1980-2010 period were computed, and countries were sorted into those with high or low levels of district magnitude according to whether they fall above or below the median of the sample (7.1). Thus, Austria, Belgium, Denmark, Finland, Italy, the Netherlands, Portugal and Sweden qualify as systems with high average levels of district magnitude, while France, Germany, Greece, Ireland, Spain and the UK have relatively low levels of district magnitude.

⁸⁶ Although Table 4.3 shows differences between 1995 and 2000, the jump in imports occurs mainly from 1999 to 2000.

Table 4.5. District magnitude in European countries, 1980-2010

Country	1980	1985	1990	1995	2000	2005	2010	Average	Level
Austria	20.33	20.33	20.33	4.26	4.26	4.26	4.26	11.5	High
Belgium	7.1	7.1	7.1	7.5	7.5	7.5	7.5	7.30	High
Denmark	7.94	7.94	7.94	7.94	7.94	7.94	13.5	8.65	High
Finland	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3	High
France	1	1	1	1	1	1	1	1.31	Low
Germany	1	1	1	1	1	1	1	1	Low
Greece	5.14	5.14	5.14	5.14	5.14	5.14	4.25	5.05	Low
Ireland	3.5	4	4	4	4	3.95	3.86	3.95	Low
Italy	19.69	19.69	19.69	1	1	1	23.73	12.5	High
Netherlands	150	150	150	150	150	150	150	150	High
Portugal	11.36	11.36	11.36	10.45	10.45	10.45	10.45	10.7	High
Spain	6.73	6.73	6.73	6.73	6.73	6.73	6.73	6.73	Low
UK	1	1	1	1	1	1	1	1	Low
Sweden	11.07	11.07	11.07	11.07	10.69	10.69	10.69	10.9	High

In terms of temporal variation, a number of patterns are discernible. Institutions are slow moving, and most countries show stable values of district magnitude over time. Thus, among the high district magnitude countries, the Netherlands, Finland, and Denmark exhibit stable patterns. Similarly for the low district magnitude countries. Germany (with the caveats described earlier), the UK and Spain present little to no variation over time. However, within both groups a number of countries exhibit substantial variation over time. Among the former, Austria went from a district magnitude of 20.33 to one of 4.26 in 1994 (shown as 1995 in the table), while Italy went from a district magnitude of 19.69 under PR to a mixed-member district system in 1993, and then back to a district magnitude of 23.73 under PR in 2006. Less dramatically, Sweden decreased its district magnitude from 11.07 to 10.69 in 1998, and in Portugal district magnitude decreased slightly in 1991. Among those countries with lower district magnitude, France switched to PR in the 1986 elections with a district magnitude of 5.79 (hence the higher average shown in Table 4.6), while both Greece and Ireland experienced a slight decrease towards the end of the period.

The above discussion illustrates a number of things. Firstly, the data show substantial variation across countries and over time. Secondly, they also point to the need to model dynamic relationships between the dependent and the explanatory variables. In particular, the likely “delay” in the effect of trade on spending identified above may be due to a number of reasons. The immediate effect of an increase in imports in year t on government spending in the same year may be small because at the micro-level adjustment processes take some time. Moreover, government budgets generally go through the legislative process and are approved prior to the year in which spending occurs, giving rise to some delay in the passing of policy. Thirdly, the above discussion calls for an empirical approach that takes into account the slow moving nature of some of the variables, such as geographical concentration. The choice of empirical strategy addresses these issues.

4.1.3 Statistical model

The analysis employs annual data from 14 European countries from 1980 to 2010, and employs a fixed-effects (FE) estimator with clustered standard errors that are robust to different kinds of serial and contemporaneous correlation. The FE specification addresses unobserved country heterogeneity and minimizes potential omitted variable bias. Given the temporal structure of the data, using clustered standard errors corrects for serial and contemporaneous correlation.⁸⁷ This strategy largely addresses the endogeneity of electoral rules. It captures the historical origins of electoral rules in Europe, which the literature has placed mostly in the late nineteenth and early twentieth

⁸⁷ The cluster covariance matrix estimator allows for error variances to differ between clusters (but not within clusters), as well as allowing for correlations between errors in the same cluster (but not between clusters). Additional analyses were run using panel corrected standard errors, as well as Driscoll-Kraay standard errors. PCSEs address contemporaneous correlation, while Driscoll-Kraay standard errors are robust to different kinds of serial and contemporaneous correlation. In the latter, the error structure is assumed to be heteroskedastic, and correlated between the panels (countries) perhaps due to common shocks, such as technology. Ignoring these correlations will cause estimated standard errors to be biased and inconsistent.

century (Boix 1999, Cusack et al. 2007). As explained below, this is possible despite the slow-moving nature of electoral rules because the analysis focuses on the interaction of electoral rules and time-varying economic conditions (also see Persson and Tabellini 2003, Chapter 8).

The inclusion of a lagged dependent variable explicitly models the policy persistence that may affect the dependent variables.⁸⁸ The analysis includes period dummies to control for the effect of shocks.⁸⁹

To examine whether the effect of electoral institutions on trade-induced compensation is conditional on the geographical distribution of trade losers, the analysis estimates a triple interaction between *Imports*, *Concentration* and *District magnitude*. Although triple interactions may bring additional complexity, estimating double interactions across sub-samples of countries also has considerable drawbacks. Splitting the sample according to an arbitrary cut-off point may lead to a substantial loss of information. Unless the results are borne out, this is arguably equivalent to running an underspecified model. Mindful of the trade-offs associated with either option, the analysis relies on the triple interaction.

The effect of district magnitude on generosity is expected to be decreasing in concentration at high levels of imports, indicating that policymakers in systems with low district magnitude cater to the interests of trade losers in concentrated settings. An OLS model with the following form is estimated:

⁸⁸ Including FE and a LDV introduces a well-known bias (Nickell 1981). Not including the LDV, of course, is likely to introduce omitted variable bias. Asymptotically, the Nickell bias goes to zero as the number of time periods increases. Importantly, Monte Carlo studies show that with political economy countries panels like the one used here, the LDV specification performs as well or better than alternative estimators (Beck and Katz 2011).

⁸⁹ Country dummies capturing 5-year periods are included: 1980-1984, 1985-1989, 1990-1994, 1995-1999, 2000-2004, 2005-2009. 2010 is the reference year.

$$\begin{aligned} Generosity_{it} = & \beta_1 Imports_{it} + \beta_2 Concentration_{it} + \beta_3 District\ magnitude_{it} + \beta_4 Imports_{it} * \\ & Concentration_{it} + \beta_5 District\ Magnitude_{it} * Concentration_{it} + \beta_6 District\ Magnitude_{it} * Imports_{it} + \\ & \beta_7 District\ Magnitude_{it} * Imports_{it} * Concentration_{it} + X_{it} + \lambda_i + \tau_t + \varepsilon_{it} \end{aligned}$$

Where λ_i is the country fixed effect, and τ_t is the period dummy. X_{it} refers to a vector of control variables and is included in all models.

4.1.4 Findings

Table 4.6 shows OLS estimates of the effect of electoral institutions on generosity of unemployment benefits, conditional on geographical concentration and imports. The estimates indicate that the effect of institutions on generosity is conditional on the geographical concentration of trade losers. Policymakers elected in systems with low district magnitude are more generous in terms of compensation than those in systems with higher magnitude when employment in manufacturing is concentrated and exposure to international competition is high.

Columns 1-4 report the findings for the triple interaction between *Imports*, *Concentration* and *District magnitude*. For each dependent variable, the first column reports the findings with country fixed effects and period dummies. The second column (columns 2 and 4) adds the lagged dependent variable. The lagged dependent variable sheds a highly significant coefficient, suggesting that a dynamic specification is needed. The findings show that the terms are individually significant in the LDV model, consistent with the notion that a dynamic model fits the data better. In addition, the standard errors are fairly precisely estimated.⁹⁰ Testing for the joint significance of the interaction terms offers some indication of the conditioning effect of institutions.⁹¹ An

⁹⁰ Static specifications with and without period effects show that the standard errors do not change much.

⁹¹ The null hypothesis of the F-test is that the coefficients of the terms interacted with institutions are each 0, so the more restrictive specification (without institutions) is as good as the more complicated one (with

F-test soundly rejects the null hypothesis that the trade-concentration-institutional variables do not jointly matter, across both specifications.⁹² The estimation results thus indicate that the effect of district magnitude on the two measures of generosity is likely to vary by level of imports and geographical concentration.

institutions). Rejecting the null thus implies that the effect of geographical concentration and trade may vary by institutional system.

⁹² The p -value for the joint test of the inclusion of Imports*Concentration, Imports*District Magnitude and Imports*Concentration*District Magnitude is 0.015 for column 2. For column 4, it is 0.004.

Table 4.6 Estimated effect of electoral institutions on benefit and ALMP generosity, 1980-2010

	(1)	(2)	(3)	(4)
	Benefit generosity		ALMP generosity	
	No LDV	LDV	No LDV	LDV
Imports	-0.0182 (0.0190)	-0.0089 (0.0054)	-0.0339 (0.0452)	0.0019 (0.0148)
Concentration	13.1622 (11.4046)	0.7646 (2.8114)	2.2345 (14.8057)	-11.3236** (4.7749)
District magnitude	-0.0531 (0.0416)	-0.0305** (0.0112)	-0.0357 (0.0405)	-0.0590** (0.0191)
Imports*Concentration	0.1489 (0.1903)	0.0172 (0.0505)	0.4531 (0.2640)	0.3239** (0.1030)
Concentration*District magnitude	1.1798 (0.6866)	0.5464** (0.1890)	0.3590 (0.7565)	0.8970** (0.3358)
Imports*District magnitude	0.0007 (0.0006)	0.0005** (0.0001)	-0.0000 (0.0008)	0.0009** (0.0003)
Imports*Concentration*D. Mag	-0.0182 (0.0131)	-0.0106** (0.0031)	0.0016 (0.0167)	-0.0186** (0.0071)
Exports	0.0029 (0.0209)	0.0082* (0.0042)	0.0023 (0.0247)	-0.0043 (0.0090)
GDP capita	0.0000 (0.0000)	-0.0000 (0.0000)	0.0000 (0.0000)	0.0000 (0.0000)
Union density	0.0005 (0.0004)	-0.0002 (0.0002)	0.0002 (0.0006)	0.0005** (0.0002)
Employment industry	0.0019* (0.0009)	0.0004* (0.0002)	0.0008 (0.0010)	-0.0000 (0.0003)
Rate unemployment	-0.0067 (0.0293)	-0.0245** (0.0076)	-0.1065** (0.0305)	-0.0406** (0.0095)
Share working population	-0.0014 (0.0380)	-0.0066 (0.0076)	0.0338 (0.0609)	-0.0046 (0.0180)
Industry value added	0.0280 (0.0271)	0.0008 (0.0054)	0.0427 (0.0317)	0.0152* (0.0077)
Left	0.0005 (0.0008)	0.0007** (0.0003)	0.0004 (0.0010)	0.0009** (0.0004)
L. Benefit generosity		0.8732** (0.0384)		
L. ALMP				0.7188** (0.0382)
Observations	365	348	320	308
Adjusted R ²	0.432	0.889	0.823	0.947

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

To better grasp the effect of district magnitude on generosity, Figures 4.1 and 4.2 plot the marginal effect of district magnitude on benefit and ALMP generosity over the range of concentration values, conditional on high levels of imports (based on the specification in column 4). High levels of imports are set at the 90th percentile. The findings show that the marginal effect of district magnitude varies across imports and levels of geographical concentration. The line in Figure 4.1 plots the marginal effect of *District magnitude* on

benefit generosity, and the confidence intervals indicate that the effect of *District magnitude* is statistically significant at the 0.05 level. The marginal effect of district magnitude on benefit generosity declines as geographical concentration increases. When trade losers are geographically concentrated, increasing district magnitude is associated with a decline in generosity. This is consistent with the claim that policymakers in systems with lower district magnitude cater to the demands of trade losers to a greater extent than those in systems with higher magnitude when they are geographically concentrated. This is also consistent with recent research on the effect of electoral rules on the provision of manufacturing subsidies (Rickard 2012, Barber 2014).

As expected, at low levels of concentration, the marginal effect of district magnitude is not statistically different from 0. This indicates that at very low levels of geographical concentration, electoral rules matter make little difference to levels of generosity. This is consistent with the claim that demand for compensation stemming from dispersed interests – less exposed to labour market risk than concentrated trade losers – is sufficiently low as to dampen political incentives facing politicians elected in systems with higher district magnitude. Where demand is low, policymakers in systems with high magnitude have lesser incentives to cater to trade losers, as the electoral gains stemming from greater spending when demand is low are reduced. Further, policymakers in systems with low magnitude have few incentives to target trade losers in particular districts. Together, the two effects lead to lower levels of compensation.

Results for ALMP generosity show a similar pattern. The marginal effect of district magnitude decreases with concentration. Although the reductive effect of district magnitude on ALMP generosity is greater than for benefits, it is also less precisely estimated, probably due to the somewhat smaller sample size.

Figure 4.1. Marginal effect of district magnitude on benefit generosity, 1980-2010

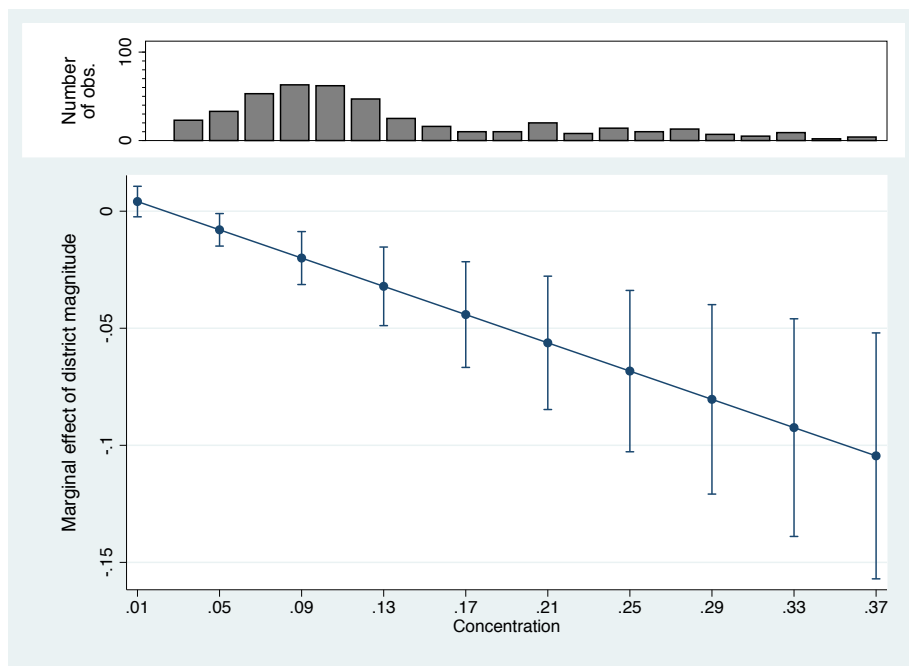
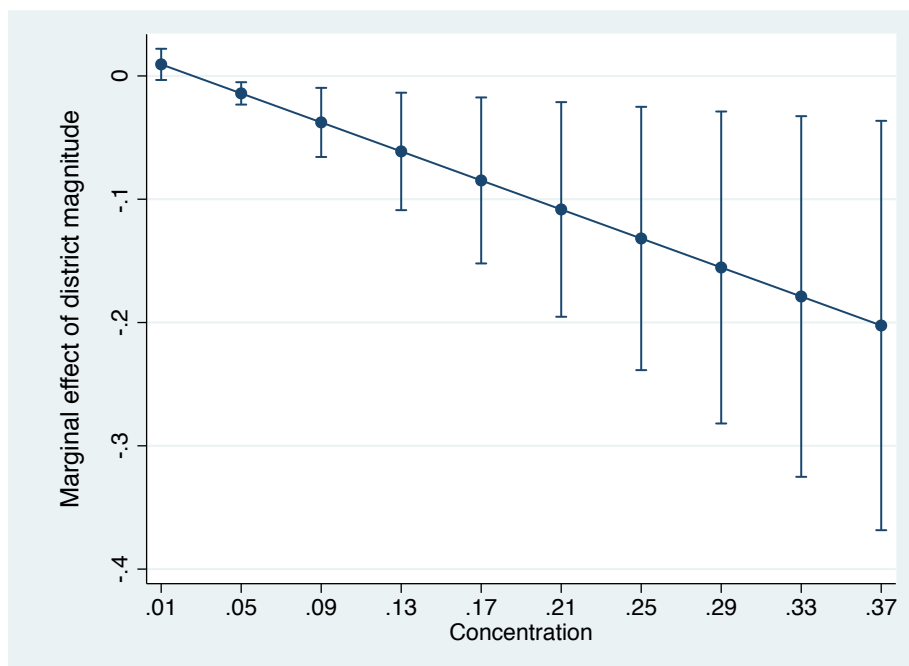


Figure 4.2. Marginal effect of district magnitude on ALMP, 1980-2010



In sum, the findings show that when trade losers are geographically concentrated, increasing district magnitude is associated with a decline in the generosity of unemployment benefits and active labour market policies. Policymakers in systems with

lower magnitude appear to be more generous than those in systems with higher magnitude when employment of trade losers is geographically concentrated. This is in line with the argument outlined in Chapter 2: given greater demand for policy stemming from concentrated trade losers, electoral rules that target geographically defined interests lead policymakers to cater to the interests of those that lose from trade. Trade losers in concentrated regions face greater labour market risk due to the reduced outside options associated with regionally specialized manufacturing industries. This increases demand for policies that address labour market risk. In turn, smaller districts induce politicians to cater to voters in select constituencies, as elections are won on the basis of districts.

Where the beneficiaries of compensation are concentrated, raising per capita spending allows policymakers to benefit from greater electoral support. In contrast, at low levels of concentration, differences between electoral institutions on generosity are significantly reduced. Relative to concentrated trade losers, dispersed interests that lose from trade are comparatively less *losing*, which, all else equal, dampens demand for compensation. When demand is low, even politicians elected in systems with high district magnitude will have reduced incentives to cater to losing interests, as the electoral gains to be derived from greater spending when demand is low are reduced.

The control variables shed interesting results. Unsurprisingly, capita GDP is negatively related with benefit generosity. Since unemployment benefits are typically redistributive, the negative coefficient is in line with studies emphasizing the negative relationship between income and redistribution. However, it is positively related with the ALMP measure, although statistically insignificant. The unemployment rate is negatively associated with both measures generosity. Union density sheds a negative coefficient for benefit generosity, but turns positive and significant for ALMP. A greater share of employment in industry leads to greater benefit generosity (but not for ALMP),

while greater shares of those in employment are associated with lower levels of generosity for both benefits and ALMP. Left government has a positive and statistically significant effect across all specifications. This latter finding is interesting, because the literature on social protection has been divided over the role of left government (Rueda 2007, Huber and Stephens 2001).

The findings are robust to the inclusion of a number of additional variables. Rickard (2012c) has argued that subsidies constitute an important tool through which governments protect voters from the costs of trade. Although the use of subsidies among EU members is restricted by the EU Agreement on State Aid, countries retain some margin to protect particular interests against foreign competition (Rickard 2008: 11). If the theorized relationship is correct, testing whether it holds for the provision of subsidies should put it to a stricter test (McGillivray 2004, Rickard 2012b). Column 1 in Table A1 in the appendix substitutes the generosity measures by a measure of subsidies (% GDP) and replicates the models in Table 4.6. The measure uses data on sector subsidies provided by the European Commission for the period 1992-2010. It comprises the sum of all state aid granted to specific sectors (such as manufacturing, coal and other services), and state aid given on an ad-hoc basis to individual companies for “rescue and restructuring”.⁹³ Figure A1 in the appendix graphs the results and shows that the relationship between trade and the level of subsidies remains unchanged.

Column 2 in Table A1 reports the findings when the analysis is run excluding Germany, which in the Bormann and Golder data is coded as a single-member district. The results are robust to the exclusion of Germany. Column 3 and Figure A2 show that substituting the measure of imports by a measure of imports plus exports as a % of GDP sheds very similar results to the ones above. Finally, the models were also replicated including a

⁹³ Importantly, the measure excludes aid for research and development, environment and energy (“horizontal objectives”) granted to specific sectors, and crisis measures.

measure of population density to control for the possibility that the latter is not highly concentrated along with manufacturing (column 4). The measure is taken from the World Development Indicators database, and counts people per square km of land area. It could be that benefits map onto the population at large rather than anything specific to the concentration of employment in manufacturing. Although the plot is not shown here, including this variable dampens the effect of district magnitude at high levels of concentration, but the qualitative relationship remains unchanged.

In sum, geographical concentration of trade losers mediates the effect of electoral institutions on the generosity of compensatory policies in open economies. Policymakers in systems with lower magnitude face greater incentives to cater to trade losers than those in systems with higher magnitude where the former are geographically concentrated. In contrast, when trade losers are dispersed, the effect of institutions on generosity of spending is dampened. The results are robust to different specifications⁹⁴ and the inclusion of several other control variables.⁹⁵ Given these findings, the following section empirically tests the effect of an additional factor: the presence of an upper house in the provision of compensation.

4.2 The conditioning effect of bicameralism

4.2.1 Hypotheses

Chapter 2 extended the argument to take into account the role of bicameralism in shaping compensation outcomes. The spatial argument developed in Chapter 2 had a number of implications. Within countries, the presence of a strong upper chamber is

⁹⁴ Models estimated using PCSEs shed very similar results.

⁹⁵ In addition to those reported above, the models included a measure of capital openness (using the *kaopen* measure made available by Chinn and Ito (2008)) and central government debt as a % of GDP). Models were also estimated using a generosity measure computed as the % of benefits (ALMP) of GDP over the rate of unemployment as a share of the civilian labour force (Rueda 2013, Iversen and Cusack 2000).

expected to dampen levels of compensation where regional veto players in the upper house prefer lower levels of policy, but this reductive effect is larger when the level of demand in the economy is higher. At low average levels of demand, regional veto players with a preference for low compensation accept a level of policy that is somewhat below the preferred level of the lower house, whereas those that prefer high compensation accept a proposal that leads to the lower house's preferred level of policy. At high average levels of demand, the presence of an upper house dominated by regional interests that prefer low compensation leads to a significantly lower levels of compensation, as regional veto players only accept a proposal that lies within their preferred set, which is substantially lower than the ideal point preferred by the lower house. Lastly, where regional veto players prefer high compensation, the lower house's proposal is accepted and becomes policy. Testing this would require fine-grained cross-national data that is not available. However, the qualitative analysis in Chapter 6 sheds light on some of these mechanisms.

Chapter 2 also emphasized that this has implications for levels of compensation across countries. In expectation, the presence of an upper house with legislative authority should lead to lower levels of compensation relative to where the former does not exist, for both majoritarian and proportional rule. Given uncertainty about where legislators' preferences lie in the real world, in some cases regional veto players may prefer greater compensation, while in others they may wish for lesser compensation. In the first case, the presence of a strong upper house will not lead to substantial changes in policy relative to unitary countries, and outcomes will be driven by electoral rules. In the second case, a strong house will lead to lower levels of policy and outcomes will be driven to a lesser extent by electoral rules. On average, therefore, in the presence of an upper house electoral rules should lead to lower levels of compensation relative to

unitary countries, *across* electoral rules. In addition, this reductive effect should be greater at high levels of demand. In the absence of a strong upper house, however, the effect of electoral institutions mirrors that described in the previous section. The following tests these implications empirically across the panel of European countries.

4.2.2 Measuring regional authority

To measure the extent of regional influence in the national policymaking process, the analysis employs Hooghe's et al.'s (2010) Regional Authority Index (RAI). The RAI captures the shared-rule and self-rule dimensions of political decentralization. Since the argument is concerned with the extent of regional influence at the national level, the shared-rule dimension is most pertinent. The measure spans the substantial variation across countries in terms of regional influence. It also captures differences in regional authority within and across bicameral and unitary countries. Bicameral countries like Spain do not have a strong second chamber, and thus rank lower than Germany or Belgium on some aspects of shared rule.

Table 4.7. Shared rule across European countries, 1980-2006

Country	1980	1985	1990	1995	2000	2005	Average	Level
Austria	5	6	6	6	6	6	5.8	High
Belgium	9	9	9	7	7	7	8.9	High
Denmark	0.1	0.1	0.1	0.1	0.1	0.1	0.1	Med
Finland	0	0	0	0	0	0	0	Low
France	0	0	0	0	0	0	0	Low
Germany	9	9	9	9	9	9	9	High
Greece	0	0	0	0	0	0	0	Low
Ireland	0	0	0	0	0	0	0	Low
Italy	0.3	0.3	1.4	1.4	1.4	1.7	1.1	Med
Netherlands	6.5	6.5	6.5	6.5	6.5	6.5	6.5	High
Portugal	0.2	0.2	0.2	0.2	0.2	0.2	0.2	Med
Spain	2.3	3	3	3	3	3	2.9	Med
Sweden	0	0	0	0	0	0	0	Low
U. Kingdom	0.1	0.1	0.1	0.1	0.5	0.5	0.2	Med

The shared-rule index captures the authority exercised by a regional government or its representatives in the country as a whole. It is an additive index ranging from 0 to 9 and is a sum of the following dimensions: the extent to which regional representatives determine national legislation, the extent to which a regional government co-determines national policy in intergovernmental meetings, the extent to which regional representatives co-determine the distribution of national tax revenues and the extent to which regional representatives co-determine constitutional change. The first dimension arguably comes closest to capturing the ability of regions to steer national legislation. However, given that most of these aspects are likely to reinforce each other in different ways, relying on the shared-rule index as a whole is meaningful.

Table 4.7 shows levels of shared-rule for all countries from 1980 to 2006, last year for which data was available. Much of the variation is between countries, although there is nonetheless some variation within countries. Like above, a first group comprises countries with low levels of shared rule: Finland, France, Greece, Ireland and Sweden. Countries with medium levels of shared rule include Denmark, Italy, Portugal, Spain and the United Kingdom. Lastly, those with high levels of shared rule are Austria, Belgium, Germany and the Netherlands. The latter has surprisingly high levels of shared rule. Table 4.6 also shows that countries such as Italy, Spain, the UK and Austria have seen increases in shared rule over the period, while Belgium experienced a slight decrease. The remaining countries exhibit fairly stable trends.

4.2.3 Statistical model

The argument predicts that the effect of electoral rules should differ across levels of regional influence for a given level of demand for compensation. Recall that demand for compensation under trade is expected to be highest when trade losers are geographically concentrated, and should be lower when they are geographically dispersed. Empirically,

testing for the conditional effect of electoral rules thus requires interacting electoral rules, exposure to imports, geographical concentration and regional authority. To examine whether the effect of electoral institutions on trade-induced compensation is conditional on regional authority and the geographical distribution of trade losers, a triple interaction between *Imports*, *Concentration* and *District magnitude* is estimated for countries with high and low levels of regional authority. This amounts to replicating the models in Table 4.6 above across groups of countries with high and low levels of regional authority.

At low levels of shared rule, the effect of electoral rules should mirror that described in section 4.1. The effect of district magnitude on generosity is thus expected to be decreasing in concentration at high levels of imports, indicating that policymakers in systems with lower magnitude cater to concentrated trade losers. At high levels of shared rule, district magnitude should be relatively less important in shaping policy. The effect of district magnitude on generosity should thus be dampened across levels of imports and concentration.

Substantively, the claim that the presence of regional interests with legislative authority dampens levels of compensation for given levels of demand requires that regions have strong policymaking powers. The cut-off point defining high and low levels of regional authority is thus set at the sum of the mean plus one standard deviation. Like above, the analysis employs fixed effects with clustered standard errors to minimize serial and contemporaneous correlation, and includes a lagged dependent variable and period dummies to control for shocks.

4.2.4 Findings

Table 4.8 reports OLS estimates for the triple interaction between *Imports*, *Concentration* and *District magnitude*, for different levels of regional authority. The estimates provide partial evidence that for a given level of demand, the effect of institutions on generosity is conditional on the level of regional authority. For the ALMP measure, the standard errors appear to be precisely estimated. Like above, policymakers in systems with lower district magnitude are more generous than those elected in systems with higher magnitude when employment of trade losers is concentrated and exposure to international competition is high. However, where regions are able to influence national policymaking, the effect of electoral institutions is dampened. The findings are not significant for the measure of unemployment benefits. This may be due to a number of reasons. The argument posits that the presence of an upper house should in expectation dampen the effect of electoral rules on benefits, since in some cases, it leads to maintaining levels of benefits (where upper house legislators prefer high benefits) while in others, it leads to lower benefits (where legislators prefer lower compensation). However, it may be that in most observations in the period under study the pivotal upper house legislator wanted greater unemployment benefits. This would mitigate the effect of the upper house on electoral rules, and policy outcomes would be driven by the latter. For instance, trends towards increased political decentralization in the period under study may lead regional representatives to push for greater benefits regardless of underlying preferences, or unemployment benefits may be politically more difficult to decrease than ALMP.⁹⁶ Arguably, the null finding for benefits may also be due to the fact that ALMP target labour market risk more closely by focusing on those factors that enable reemployment.

⁹⁶ A measure of self-rule was included in the analysis to capture policy autonomy stemming from decentralisation (available from the RAI). The results do not change.

Table 4.8. Estimated effect of electoral institutions on generosity conditional on regional authority and the geographical concentration of trade losers, 1980-2006

	(1) Benefits Shared rule		(2) ALMP Shared rule	
	Low	High	Low	High
Imports	-0.0085 (0.0074)	-0.0010 (0.0127)	-0.0221 (0.0196)	0.0007 (0.0115)
Concentration	1.1251 (3.2512)	-45.9641 (26.2026)	-23.5305** (4.7919)	-85.9237** (34.9084)
District magnitude	-0.0484** (0.0159)	0.1626 (0.1416)	-0.0578 (0.0400)	-0.2149 (0.1494)
Imports*Concentration	-0.1032 (0.1155)	-0.1162 (0.0977)	0.8649** (0.1885)	0.6217 (0.3719)
Dist. Magnitude*Concentration	0.3970 (0.3236)	0.6246 (0.6516)	1.4361** (0.5818)	4.7413** (1.8040)
Imports*District Magnitude	0.0002 (0.0005)	0.0003 (0.0005)	0.0021** (0.0008)	0.0038** (0.0013)
Imports*Concentration*D. Mag	0.0116 (0.0134)	-0.0053 (0.0112)	-0.0581** (0.0171)	-0.0812** (0.0302)
Exports	0.0068 (0.0055)	0.0064 (0.0103)	-0.0015 (0.0105)	-0.0299* (0.0144)
GDP capita	-0.0000 (0.0000)	-0.0000* (0.0000)	0.0000* (0.0000)	0.0000 (0.0000)
Union density	-0.0002 (0.0002)	0.0006 (0.0004)	0.0005** (0.0001)	-0.0004 (0.0004)
Employment industry	0.0003 (0.0004)	-0.0000 (0.0002)	0.0006 (0.0007)	-0.0011 (0.0010)
Rate unemployment	-0.0224** (0.0068)	-0.0414** (0.0074)	-0.0318** (0.0102)	-0.0695** (0.0065)
Share working population	0.0017 (0.0169)	-0.0024 (0.0287)	-0.0146 (0.0289)	0.0547** (0.0239)
Industry value added	0.0065 (0.0133)	-0.0070 (0.0082)	0.0094 (0.0168)	0.0063 (0.0111)
Left	0.0004 (0.0002)	0.0004 (0.0005)	0.0007** (0.0002)	0.0018** (0.0007)
L. Benefit generosity	0.8241** (0.0571)	0.5824** (0.0917)		
L. ALMP generosity			0.7381** (0.0433)	0.4165** (0.0401)
Observations	240	108	203	105
Adjusted R ²	0.891	0.859	0.940	0.973

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Figure 4.3 plots the marginal effect of district magnitude for the measure of ALMP generosity over the range of concentration values for high levels of import exposure, conditional on low and high levels of regional authority.⁹⁷

The findings for the measure of ALMP provide clear support for the expected relationships. Figure 4.3 plots the effect of district magnitude on generosity of active labour market policies. The plots show that the marginal effect of district magnitude varies across levels of shared rule, for high levels of imports and geographical concentration. In line with expectations, the marginal effect of district magnitude on ALMP generosity is negative, indicating that increased proportionality is associated with reduced generosity as geographical concentration increases, for high import exposure. Consistent with expectations, Figure 4.3(a) shows that at lower levels of shared rule the marginal effect of district magnitude mirrors that in Figures 4.1 and 4.2. Thus, in the absence of a strong upper house with policymaking authority, policymakers in systems with lower magnitude cater to concentrated trade losers to a greater extent than in those with higher magnitude. Figure 4.3(b) plots the effect of district magnitude for high levels of shared rule. At high levels of shared rule, the slope corresponding to the effect of district magnitude for high imports is considerably less steep, and loses significance. This indicates that for given levels of demand for compensation, where regions are capable of exerting influence in the national policymaking process the effect of electoral rules is reduced. This provides support for the notion that where regions have policymaking authority, the effect of electoral rules on compensation is lessened, as policy outcomes are driven to a greater extent by legislative bargaining.

⁹⁷ For parsimony, the graph showing the marginal effect for the measure of benefit generosity is not shown. The results are not statistically significant.

Figure 4.3(a). Marginal effect of district magnitude on ALMP generosity for high import exposure, conditional on low levels of shared rule, 1980-2006

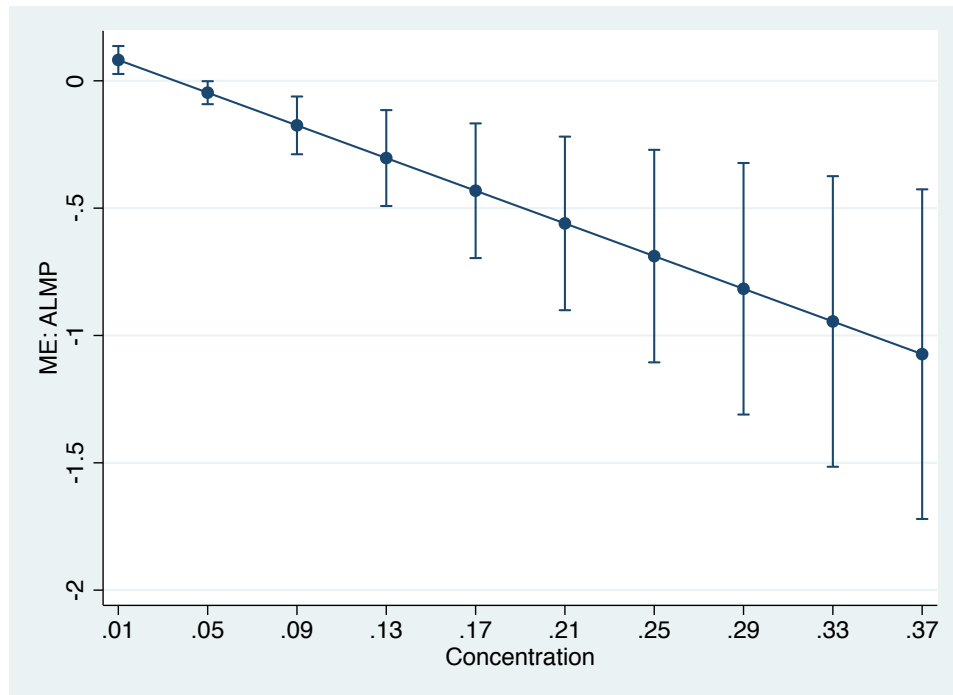
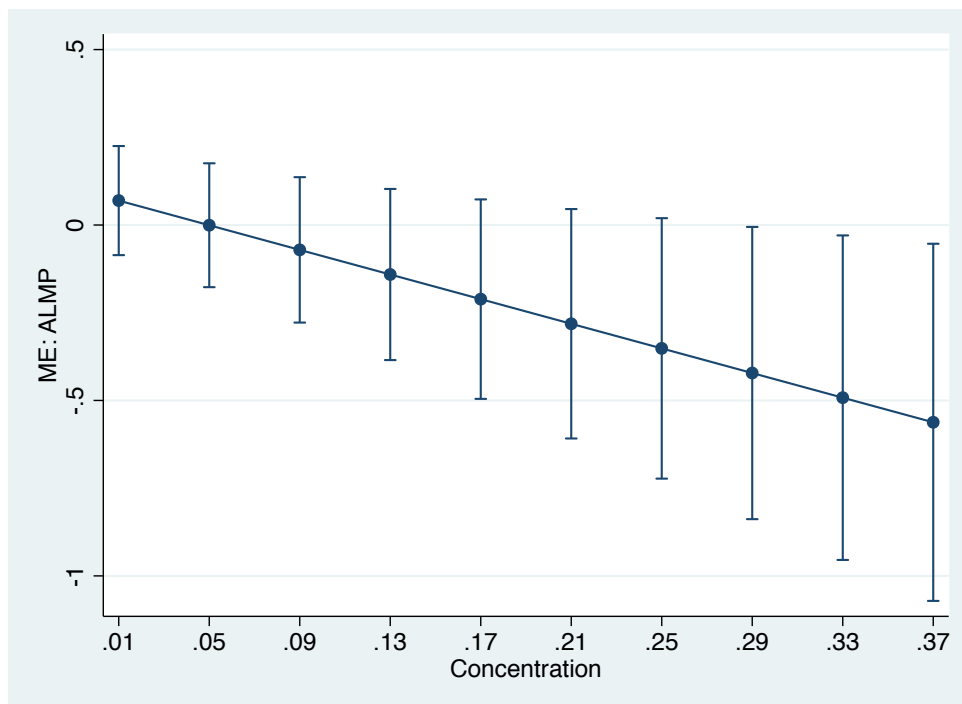


Figure 4.3(b). Marginal effect of district magnitude on ALMP generosity for high import exposure, conditional on high levels of shared rule, 1980-2006



4.3 Conclusions

The above analysis has shown that the effect of electoral institutions on compensation in open economies is conditional on the geographical distribution of trade losers.

Policymakers in plurality systems with lower district magnitude are more responsive to the preferences of concentrated trade losers than those in proportional systems with higher magnitude. This is consistent with the argument spelled out in Chapter 2. In systems with lower magnitude, policymakers have greater incentives to target geographically defined constituents. Geographically concentrated trade losers face greater labour market risk, and thus demand greater compensation relative to trade losers in diversified regions. To the extent that such groups of voters prefer greater levels of compensation, plurality systems are likely to translate into increased levels of policy. In contrast, at low levels of concentration, differences between electoral institutions on compensation generosity are significantly reduced. Relative to concentrated trade losers, dispersed interests that lose from trade are comparatively less *losing*, which, all else equal, dampens demand for compensation. When demand is low, policymakers across proportional and plurality systems face lesser incentives to increase compensation. Those elected in larger districts have little to gain by targeting policy to geographically concentrated trade losers at the expense of more dispersed groups of voters, while lower levels of demand reduce incentives to increase compensation under plurality elections.

These findings echo recent research emphasising that under certain conditions, the relationship between electoral institutions and trade protection may run counter to conventional views (Rickard 2012b, Barber 2014). The above findings show that the interaction between the demand and supply of policy linked to geographical concentration and electoral rules, respectively, also applies to nominally programmatic spending that address a broad set of beneficiaries. That the geographically induced

effects of electoral institutions hold even for such broad programmes testifies to the strength of the latter and the need to take into account the role of geographical risk.

However, the analysis also indicates that the effects of electoral rules tend to be limited in the presence of a strong upper house. When regions have the capacity to influence national policymaking, electoral rules make less of a difference. The findings in section 4.2 show that the effect of electoral rules on compensation is shaped by the policymaking authority of regional interests at the national level. Specifically, at low levels of regional authority, district magnitude has a negative marginal effect on compensation generosity when trade losers are geographically concentrated. At high levels of regional authority, however, the effect of electoral rules is dampened. The findings for the measure of ALMP provide strong evidence in support of this, but not so for unemployment benefits. Overall, however, the findings provide support for the notion that where regions have policymaking authority, policy outcomes are driven to a greater extent by legislative bargaining.

In so far as it does not distinguish between the preferences of regional policymakers, however, the analysis provides a partial test of the implications regarding the effect of bicameralism. Chapter 6 addresses this by carrying out a qualitative analysis that distinguishes between the preferences of regional representatives with and without veto power, and clarifies the ways in which the presence (or absence) of regional veto players shapes policy outcomes. Before that, Chapter 5 further explores the micro-foundations of the model through an in-depth analysis of preference formation in selected regions.

Appendix

Table A4.1. Robustness checks.

	(1) Subsidies	(2) Minus Germany	(3) Trade volume	(4) Population density
Imports	-0.0051 (0.0146)	-0.0103 (0.0064)		
Concentration	28.0470* (13.2897)	-1.1004 (3.5011)	3.2129 (2.8378)	2.1432 (2.5601)
District magnitude	-0.1823** (0.0822)	-0.0373** (0.0140)	-0.0275** (0.0109)	-0.0327** (0.0103)
Imports*Concentration	0.2243 (0.1725)	0.0601 (0.0611)		
Concentration*District Magnitude	3.2818** (1.3927)	0.6694** (0.2452)	0.4757** (0.1830)	0.5303** (0.1672)
Imports*District Magnitude	0.0028** (0.0011)	0.0006** (0.0002)		
Imports*Concentration*District Mag.	-0.0605** (0.0241)	-0.0127** (0.0044)		
Exports	-0.0025 (0.0092)	0.0064 (0.0044)		
GDP capita	-0.0000 (0.0000)	-0.0000 (0.0000)	-0.0000* (0.0000)	-0.0000* (0.0000)
Union density	-0.0004 (0.0014)	-0.0001 (0.0002)	-0.0001 (0.0002)	-0.0001 (0.0002)
Employment industry	0.0006 (0.0006)	0.0006** (0.0003)	0.0004* (0.0002)	0.0004** (0.0002)
Rate unemployment	-0.0073 (0.0151)	-0.0217** (0.0075)	-0.0210** (0.0065)	-0.0226** (0.0066)
Share working population	0.1155** (0.0310)	-0.0034 (0.0129)	-0.0064 (0.0079)	-0.0059 (0.0073)
Industry value added	0.0200** (0.0076)	0.0014 (0.0077)	0.0032 (0.0052)	-0.0009 (0.0066)
Left	0.0001 (0.0006)	0.0007* (0.0003)	0.0007* (0.0003)	0.0007** (0.0003)
L. Subsidies	0.2322** (0.0629)			
L. Benefit generosity		0.8628** (0.0457)	0.8648** (0.0397)	0.8753** (0.0413)
Trade volume			0.0019 (0.0013)	0.0021 (0.0013)
Trade*Concentration			-0.0278 (0.0261)	-0.0305 (0.0225)
Trade*District Magnitude			0.0002** (0.0001)	0.0002** (0.0001)
Trade*Concentration*District Mag.			-0.0042** (0.0014)	-0.0037** (0.0012)
Population density				-0.0045* (0.0024)
Observations	218	318	348	339
Adjusted R^2	0.412	0.890	0.888	0.888

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Figure A4.1. Marginal effect of district magnitude on subsidies (% GDP)

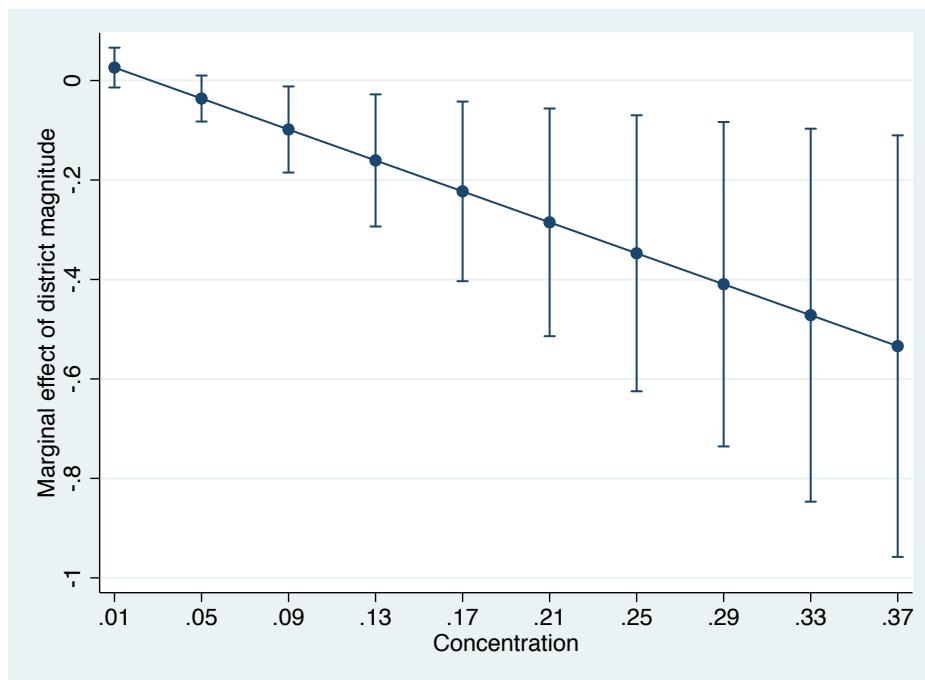
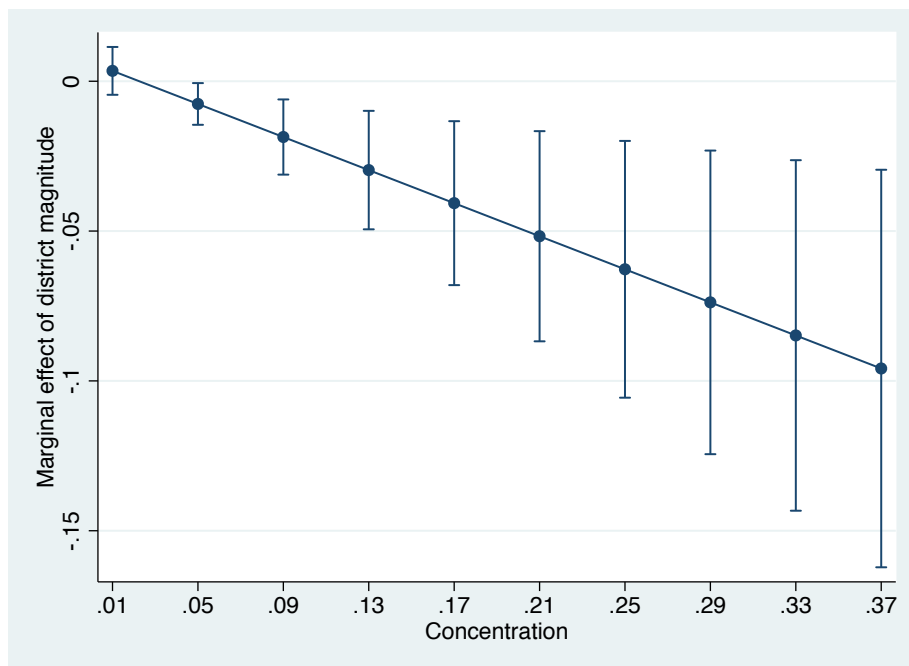


Figure A4.2. Marginal effect of district magnitude on benefit generosity using volume of trade as predictor



Chapter 5

Geographical concentration and preferences for compensation in Spain and Argentina: a regional analysis

Chapters 3 and 4 have provided a systematic analysis of preferences for compensation and policy outcomes in open European economies. The case studies presented in Chapters 5 and 6 complement the cross-country analyses by offering an in-depth study of preference formation and policy outcomes in two case studies. This chapter aims to clarify the influence of geographical concentration on the formation of preferences in Spanish and Argentine regions. The regional analysis makes it possible to examine developments in the context of economic liberalization in both countries, and trace the causal processes shaping the formation of preferences.

Why were some workers employed in losing industries privileged in some areas, but not others? The argument offered in Chapter 2 claimed that the answer to this question lies in the interaction between preferences for compensation stemming from regional economic structure and institutional arrangements shaping political incentives. In particular, it argued that individuals employed in losing industries in specialized and uncompetitive regions were more likely to support compensation relative to similar individuals in diversified regions. It also claimed that similar individuals in competitive and diversified regions were least likely to demand compensation, while those in specialized regions faced conflicting pressures.

This chapter tests such claims using quantitative and qualitative data from Spanish and Argentine regions. Spain and Argentina are good cases for comparison. In addition to

undergoing deep processes of liberalisation, both countries offer significant variation in terms of the main independent variables at the regional level.⁹⁸

The chapter complements the statistical analysis of survey data with in-depth studies of selected regions. The purpose of exploring such cases in detail is to establish that regional features posited by the argument were decisive in shaping demand for compensation. While the statistical analyses provide a rigorous test of the theoretical claims, the regional cases identified below illustrate how the interaction of regional competitiveness and specialization can play a role in shaping demand for compensation. The combination of quantitative and qualitative analyses of preference formation provides evidence in support of the theoretical claims.

A first section reviews the experience of trade liberalisation in Spain and Argentina and provides backdrop to the analyses that follow. The second section quantitatively explores the determinants of support for compensation in Spanish and Argentine regions. The third section focuses on the selected cases. It first justifies the selection of regions for compensation and then delves into the study of preferences in each. Together, the quantitative and qualitative analyses provide evidence in support of the main implications stemming from Chapter 2. Demand for compensation was higher among regions that are both specialized and reliant on uncompetitive sectors. In turn, support for compensation appears to be lower in competitive specialised regions. However, consistent with the argument, the qualitative study shows that such regions also faced high risk, illustrating the potential variability in support for compensation.

⁹⁸ The analysis on Argentina is limited to the period 1989-1995, for a number of reasons. Arguably, the onset of structural reform processes in Argentina makes it difficult to isolate the effects of trade liberalisation from other reforms (such as adjustment in the public sector). The most significant liberalisation in trade occurred in the period 1989-1993, and was followed by reform in the public sector mostly from 1994 on. Secondly, the advent of Mercosur in 1998 was a process of endogenous liberalisation that led to further reductions in tariffs.

5.1 Trade liberalisation in Spain and Argentina

5.1.1 Liberalisation in Spain

To understand differences in the level of demand for compensation between the two regions, it is useful to review the historical development of Spanish industry and the role played by the prospect of membership of the European Community in trade liberalisation. Trade liberalization in Spain was in large part a result of European Community (EC) membership negotiations and changes in the oil price that followed the 1974-1975 shocks. The 1974-75 oil price shock had precipitated a deep crisis in the European steel industry, leading to a state of excess capacity that led the European Coal and Steel Community (ECSC) to declare a state of “manifest crisis” of European steel in 1980 (Houseman 1991).⁹⁹ The crisis extended to strategic and steel-using sectors – such as oil or shipbuilding – that relied heavily on energy supplies. Production of crude steel in European countries in 1985 was almost 30% lower than in 1974 (Houseman 1991). Spanish heavy industry, in particular steel and shipbuilding, followed a similar trend. Although less affected by the glaring gap between consumption and production, Spanish steel was nonetheless beset by excess capacity (Guereca 1986). The declaration of the state of “manifest crisis” led to the introduction of production quotas and minimum prices, together with a system of state aid conditional on the reduction of productive capacity among European manufacturers. In the context of Spain’s EC membership negotiations, this had stark implications. Membership of the ECSC required a restructuring of industry to converge to European levels of competitiveness – to which aid packages were attached. The conditions for membership were thus particularly stringent in the industrial chapter and reflected the difficult economic situation faced by

⁹⁹ Several factors accounted for the excess capacity, including a drop in the demand for steel, and rapid product and process innovations that left European steel uncompetitive in world markets (Houseman 1991: 1).

European steel, which extended to other steel-using industries such as shipbuilding. Spain had committed to a reduction of its production capacity of 3 million tonnes, in return for which Spanish firms would continue to benefit from state aid until 1986 (Navarro 2004).

EC commitments triggered a first wave of government measures to restructure industry (Navarro 1990, Gunther 1996). Decree Law 9/1981 on measures of reconversion signed on June 5 later became Law 21/1982, spelled out a number of financial and fiscal measures underpinning the reconversion of industrial sectors, and provided a legal framework for some of the ad hoc interventions already in place.¹⁰⁰ However, the system of subsidies was kept in place, and restructuring did not fundamentally bring about a change in relative prices. EC membership negotiations had begun in early 1979, but subsequently stalled for economic reasons. Membership involved deep economic reforms that the Suarez government, concerned with democratic stabilisation, was reluctant to push through.¹⁰¹

The impending prospect of EC membership triggered a second and more comprehensive programme of economic liberalisation under the PSOE government, elected in 1982 (Navarro 1989, 1990, Maravall and Fanjul 1987). In addition to the ECSC, membership of the common market involved a reduction of trade barriers and the dismantling of the system of protection in place under the Franco dictatorship – known as industrial reconversion. As emphasised by a former top policymaker under the PSOE government:

“[Industrial restructuring] was a response to a global context, which was however linked to problems specific to Spanish industry. For instance, the shipbuilding industry faced

¹⁰⁰ In a brief period of time, two decrees were approved for industrial reconversion: Decrees 2200/1980 of September 26 for the reconversion of the home appliances sector and Decree 2206/1980 of October 3 for special steels. Also during the Suarez period, negotiations for the reconversion of integrated steel were begun, eventually leading to Decrees 878/1981 in May.

¹⁰¹ A signal of the interest of the EC in pushing for Spanish membership, in the wake of the 1981 coup, the European Parliament demanded that negotiations be accelerated to stabilize democracy, but they stalled again in late 1981 over the introduction of VAT.

two problems. One [was] a problem of global demand but also of competition from eastern shipyards whose production costs were much lower. The problem was global. And then [there was] EU membership. This was an important aspect in two respects. Membership imposed discipline in terms of public aid. The economic crisis gripping [Spain] had been triggered by the oil shocks, and was growing [since then]. Once part of the EC in 1986, we [would have been] subjected to control of public aids, with a transitory period – but even then one had to begin to accept the *acquis communautaire* in terms of competition policy and public aid. This had two dimensions. Firstly, that you had a body exogenous to the Spanish government and parliament that imposed discipline. Secondly, that from a political point of view it facilitated vis-à-vis public opinion and labour unions the adoption of measures that would previously have been very difficult [to adopt], to the extent that it was in no way a unilateral decision but rather was imposed by a discipline associated to [Spain's] membership of the EU... In the pre-1986 period, and independently of the EU, there was a problem linked to uncompetitive industries that absorbed a growing amount of public aid. The alternative would have been to continue with public subsidies, increasingly detracting public resources to target industries that had no future. ... [Later] the EU provided an explicit and defined framework, with disciplining measures that responded to defined patterns. This facilitated the task [of restructuring]”.¹⁰²

In short, industrial reconversion sought to transform the structure of industry in order to regain competitiveness in the context of impending European economic integration and increased global competition. The new measures led to the articulation of existing policy provisions into a consistent legal framework and backed with increased financial resources. Law-Decree 8/1983 on Reconversion and Reindustrialization set the stage for what later became Law 27/1984 of Reconversion and Reindustrialization. The law empowered the government to carry out a process of industrial restructuring which effectively dismantled the system of industrial subsidies in place until then and revamped the organization of production. It also enabled the government to administer a variety of financial, fiscal and social measures to affected industries. Among them were financial subsidies (such as soft loans and warranties channelled by the state bank to private companies or direct cash transfers to increase a firm's capital), fiscal measures such as tax exemptions and unemployment benefits and activation programmes targeted

¹⁰² Interview, Madrid, March 7, 2012.

to workers.¹⁰³ This would enable sectors to cope with changes in relative prices and the associated drop in real returns and employment levels.¹⁰⁴ Initially restricted to eight sectors, by early 1983 the reconversion process affected as many as eleven sectors.¹⁰⁵

Two mechanisms put forth by the law are important to understand how preferences for compensation were formed. Firstly, the new law paved the way for a variety of sector-specific plans to downsize industrial production.¹⁰⁶ Capacity cuts and workforce reduction were two explicit goals of reform. Secondly, Law 27/1984 incorporated mechanisms to foster the industrial concentration of existing companies (private and public) in order to rationalize tasks and increase efficiency. Among others, the emphasis on productive efficiency involved helping efficient firms to facilitate mergers that would result in the creation of big public groups in each sector, later sold to foreign multinational companies (Etchemendy 2011). This involved closure of plants deemed inefficient in favour of revamping others located in other areas. To achieve this, the law relied on reconversion societies (*Sociedades de Reconversion*), designed to promote joint ventures between private companies (or between private companies and the state) to increase efficiency and pave the way for future mergers (Maravall and Fanjul 1987). In turn, *Gerencias* or state agencies specific to the industrial sector declared under

¹⁰³ These programmes will be analysed in detail in Chapter 6.

¹⁰⁴ Some tariffs remained in place until 1986, and were further reduced with EU membership (Bajo and Torres 1990).

¹⁰⁵ Among them were: home appliances, steel (integrated, special and common), textiles, electrical equipment, non-metallic minerals, shipbuilding, electronic components, leather, metal forging. In addition, the government declared the fertilizers sector under reconversion and a number of industrial groups in the chemicals, auto and metal forging sectors.

¹⁰⁶ Article 17 of the law established that approval of a reconversion plan would be “considered technological, economic or technical cause for firms under reconversion to modify, suspend or terminate employment relationships...”

reconversion were designed to monitor the adjustment process and administer financial and fiscal measures to cushion the latter.¹⁰⁷

*Table 5.1. Workforce reduction from industrial reconversion, 1982-1989*¹⁰⁸

Sector	Period	Firms	Initial	Projected	Layoffs	Total %	Initial %
Shipbuilding large	1984-90	2	21920	9972	11948	13.31	54.51
Shipbuilding small/med	1984-90	27	15427	8198	7229	8.05	46.86
Steel (integrated)	1980-90	3	42837	22761	20076	22.36	46.87
Steel (specialty)	1980-90	11	13744	5016	8728	9.72	63.50
Heavy forging	1981-84	2	1277	970	307	0.34	24.94
Metallic Minerals	1981-84	4	4503	3430	1073	1.20	23.83
Home appliances	1980-88	18	23869	11258	12611	14.05	52.83
Textiles	1981-86	683	108844	98919	9925	12.06	9.12
Fertilizers	1981-88	10	8541	6517	2024	2.25	23.70
Electronic comp.	1981-85	17	3744	2200	1544	1.72	41.24
Auto electrical equipment	1981-85	2	6720	5378	1342	1.49	19.97
Other	1983-91	12	23985	16017	12968	14.4	54.0
Total		791	280410	190636	89775	100%	32.83

Source: Ministerio de Industria y Energía, *Informe sobre la Industria Española 1988* (Madrid, MINER, 1988). *Other* includes: the firm Marconi (electronics), employing 2548 workers at the onset of reform; Alcatel electrics, with 16133 workers and Explosivos Rio Tinto (fertilizers), with 10304 workers and 10 firms.

The combination of capacity cuts, downsizing and industrial concentration had enormous costs in terms of employment. One-third of employment in sectors subjected to reconversion was lost during the period 1981-1988, with losses of almost 90000 jobs over an initial 280000 (Table 5.3).¹⁰⁹ In sectors such as shipbuilding, special steels and home appliances, arguably the core of restructuring in terms of capacity and employment (Maravall and Fanjul 1987, Navarro 1990: 118), this translated into a reduction of over half of the labour force.¹¹⁰ This could be expected to have very

¹⁰⁷ Although unions and employers were required to participate in the implementation of the plans, reconversion plans were designed by state officials in the Ministry of Industry as well as the *Gerencias* (García Valverde 1982).

¹⁰⁸ Table 5.3 does not provide an exhaustive list of firms subjected to reconversion. While the main sectors are included, other groups of firms selected for reconversion are not included.

¹⁰⁹ This figure does not include jobs lost during the period 1980-1981, particularly in shipbuilding, nor those that followed the period 1988-1991, for lack of data availability.

¹¹⁰ In integrated steel and small and medium shipyards, reconversion led to a reduction of 40% of the workforce, while in the remaining sectors it led to a reduction of 25%.

different effects across regions. While this had stark consequences across uncompetitive regions, specialised regions, in particular, faced even greater risks.

5.1.2 Liberalisation in Argentina

In the post-war period, Argentina adopted an inward-oriented developmental strategy that relied on a strong role of the state in the economy and heavy protectionist policies.¹¹¹ Government surpluses in the post-war period enabled the promotion of state-owned enterprises and the development of import substitution industries to service domestic demand. State participation in the immediate post-war period was initially limited to heavy industry, but from the 1970s expanded to intermediate goods and consumer durables (Etchemendy 2011: 71).¹¹² The 1966-73 military dictatorship launched a National Development Plan that supported intermediate goods in chemicals and steel, and the 1976-83 regime considerably deepened state support for core ISI sectors through its policies of industrial promotion. Industrial promotion regimes extended state subsidies to the bulk of core ISI intermediate goods and provided tariff-free imports of inputs and capital goods as well as tax exemptions (Azpiazu 1989, Sawers and Massacane 2001).¹¹³ Protectionism in manufacturing swelled budget deficits and drove inflation, and strengthened the power of organised labour groups (Schamis 1999, Etchemendy 2011: 71-74). Aiming to increase economic efficiency and weaken the demands of protectionist groups, the military regime embarked on a policy of economic liberalisation in the late 1970s.

¹¹¹ A more detailed discussion is provided in Chapter 6.

¹¹² From 1946 to 1955, the Peronists focused on the more labour-intensive ISI industries such as textiles, food or simple metals. State participation under the Frondizi government (1958-1962) was mainly focused on oil (through the state monopoly, YPF) and the steel and petrochemical sectors (through the military-run companies). Cf. Etchemendy (2011: 71).

¹¹³ This included sectors such as petrochemicals, chemicals, steel, pulp, aluminium and cement, but also durables such as electrical and home appliances (Azpiazu 1989). Under industrial promotion regimes, provincial governments gained the authority to approve exemption from federal taxes for projects less than \$1 million. This led to the exponential growth of approved projects in the region (Sawers and Massacane 2001).

The regime liberalised trade (although the extent of tariff reduction was limited) and set up a policy of preannounced devaluations to address inflation. However, set at below-inflation rate levels to reduce inflationary expectations, the preannounced exchange rate increased real appreciation, which together with the oversupply of foreign credit led to the accumulation of trade deficits and a run on the currency in 1981 (Schamis 1999). This exacerbated political instability, eventually leading to the cessation of credit in 1982 (Frieden 1991). The fiscal crisis triggered by the drying up of external funding increased pressure for adjustment under Raul Alfonsín's (from the *Union Civica Radical*) democratically elected government, but conflicting social demands in the wake of transition to democracy made this difficult (Palermo and Novaro 1996). Failed attempts at reform increased the depth of crisis, and the skyrocketing inflation that followed led the Peronists back to office in May 1989.

In dire need of external funds to address the acute fiscal crisis, the incoming government led by Carlos Menem embarked on a broad programme of economic reforms (Stokes 2001, Gerchunoff and Torre 1996). This led to the implementation of structural reform and stabilisation programmes that involved liberalizing trade and capital flows, privatising state companies and stabilizing the currency. The State Reform Law of August 1989 made all public companies eligible for privatization, while the Economic Emergency Law, passed in September, provided the executive with extra powers to speed the process. This legal framework paved the way for the elimination of industrial subsidies, the reduction of import restrictions, cuts in public expenditures and employment and increases in tax collection. In the second half of 1989, average tariff rates decreased by 50% and import quotas were eliminated. The average (nominal) tariff was reduced to 26% in 1989 and to 17% at the end of 1990. The structure of protection was biased towards final consumption goods (such as automobiles and home

appliances), which benefitted from an average tariff rate of 20%. In contrast, trade liberalization mostly affected raw materials (0% average tariff rate), intermediate goods (rubber, paper, basic metals and chemicals) where protection rates were slashed to between 5 and 10%, and capital goods (such as plastics, metal products and textiles) where protection amounted to 15% (Gerschunoff and Torre 1996). Trade liberalization was followed by a nominal exchange rate anchor, which led to an appreciation of the currency. In March 1991, Congress approved the Convertibility Law, which pegged the peso one-to-one to the dollar.

Two features were distinctive of trade liberalization in the 1990s and help explain how preferences for compensation were formed. First, liberalization in the 1990s was characterized by a much greater exposure to imports relative to the 1980s (Bisang et al. 1996). Thus, in addition to greater levels of trade openness, the 1990s saw a change in its composition: exposure to imports attained almost two-thirds of total openness, whereas in the late 1980s it barely attained 50% levels of openness. In addition, while the fixed exchange rate curbed inflation and restored business confidence (Gerchunoff and Torre 1996), currency appreciation also harmed manufacturing exports during a period of productive restructuring (Schamis 1999, Treber 2001). It also introduced wage rigidities that prevented the labour market from adjusting to external shocks via wages, leading to adjustment through employment levels (Lindenboim 2001, Bekerman 1998). In the words of a renowned academic:

“The process of trade openness was part and parcel of a macroeconomic scheme that pursued structural reform of the economy, on the one hand – and this was driven by the idea of eliminating selective policies and going towards pro-market mechanisms – and economic stabilization, on the other – recall that Argentina is one of the most volatile economies in the world, with inflationary processes, etc. In the late 1980s, in response to pressure from international organizations, tariffs decrease, and this happens prior to convertibility... The process of liberalization in the 1990s had two instruments. The

problem... was that there was a strong change in relative prices followed by currency appreciation – to control inflation.”¹¹⁴

Secondly, although ISI had been accompanied by a generous system of welfare provision, the existing level of unemployment protection was very low. Like many Latin American countries in the post-war period, Argentina enjoyed a relatively generous welfare system, made possible by the inward-oriented developmental strategy adopted in the post-war period (Mesa-Lago 1985). The turn towards ISI in the post-war period involved the promotion of state-owned enterprises, protectionist policies and generous social benefits. Also like in many Latin American countries, however, the provision of unemployment benefits and active labour market policies was virtually non-existent. A non-contributory unemployment benefit had been created under the Alfonsín government (Decree 2485, December 1985) entitling unemployed workers who had been in formal employment for at least one year to benefit from a transfer (equivalent to 70% of the minimum salary) as well as family allowances and health contributions. The benefit did not require prior contributions, but was only valid for a period of 4 months and was limited to workers without family responsibilities (Cetrangolo and Golbert 1995).¹¹⁵

Trade liberalization had harmful effects on manufacturing workers. According to Argentine Census data, the number of workers in manufacturing decreased by 42% between 1991 and 2001, going from 16% to 8% of the active population in the same period. Etchemendy (2011) reports differences in the impact of unemployment by sector, with a reduction of 47% of the workforce in the steel sector and 85% in the oil

¹¹⁴ Interview, Buenos Aires, December 12, 2012. This is also consistent with the notion advanced in the introduction that while the decision to liberalize trade arguably responded to international pressures, the currency peg was a response to the hyperinflation that gripped the country in late 1990 and early 1991.

¹¹⁵ In addition, an Unemployment Fund for Workers in the Construction Industry was created in 1980 (Decree 22250).

sector. Given the unequal distribution of unproductive sectors across Argentine regions, trade liberalisation could be expected to have very different effects across regions.

Workers in uncompetitive and specialised regions had good reason to behave differently than similar workers in diversified regions. The next section tests the effect of regional characteristics on support for compensation among Argentine and Spanish regions.

5.2 A cross-sectional analysis of preferences over compensation

This section systematically tests some of the key implications stemming from the argument in Chapter 2 for Spanish and Argentine regions. The argument posits that relative to those in diversified regions, individuals employed in losing industries in specialized and uncompetitive regions are exposed to greater risk and thus demand greater compensation. In turn, those facing negative income effects from trade in competitive and diversified regions are expected to demand relatively low levels of compensation. In diversified regions, individuals face greater outside options and benefit from the employment effects of diversification. In specialized and competitive regions, the expected effect of trade is ambiguous: high competitiveness dampens support for compensation, but limited mobility increases it. Chapter 1 outlined the reasons why Spain and Argentina were good cases for comparison. As will become apparent below, both countries also offer significant variation in terms of the main independent variables at a regional level.

The data used in the analysis make it possible to test the implications of the argument during relevant periods of liberalization in Spain and Argentina. Unfortunately, they do not allow for a test of regional effects across individual industry of employment, as was done in Chapter 3. Nonetheless, the findings provide evidence in support of the claim

that regions with higher levels of demand were also those that were most specialized and uncompetitive.

5.2.1 Analysing preferences for compensation across Spanish regions

To assess whether individual preferences towards compensation correlate with regional competitiveness and specialization, the analysis relies on a cross-section of survey data for Spanish and Argentine regions, complemented with regional level data on trade and employment by sub-sector. For Spain, the analysis relies on a survey fielded in July 1983 across all Spanish regions, excluding Ceuta and Melilla.¹¹⁶ Data are available from the Centre for Sociological Research in Spain, and cover 16 industries in 17 regions. The survey was fielded at a time when the PSOE government had already embarked on reconversion, but most dismissals had not been realised. It is thus likely to reflect expectations about demand, and, if anything, provide a conservative estimate of preferences for compensation.

The dependent variable

Preferences for compensation were measured using an item tapping into individual support for the reconversion process. The item asks respondents the following question: “One of the reasons for which the State is losing so much money every year is that some of the large public companies such as the steelworks in Sagunto and the shipyards of Gijon, Vigo and Cadiz, for instance, produce more than they can sell or are obsolete and cannot compete in the markets. In this case, what should the government do?” A first response category states that the government should “avoid the rise of unemployment at all costs, even if financial losses are increasing” (taking on a value of 1 in the analysis). A second response category states that the government should “reform and modernize

¹¹⁶ The study (CIS1361) is available online at www.cis.es.

such companies even if employment is lost” (taking on a value of 0). The variable does not directly capture support for compensatory measures such as increased unemployment benefits or activation programmes. However, there are also clear advantages to using such a measure. The item makes clear the costs of avoiding unemployment, and makes references to some of the most salient instances of restructuring.

The independent variables

The measure of regional competitiveness is a weighted sum of sector productivities in a region, where the weight is a given sector’s share of regional employment. Greater productivity signals greater competitiveness, so more productive sectors may be expected to have a greater propensity to export. For Spanish regions, productivity is computed as the ratio of sector value added to the number of employed in the sector, and data were taken from the OECD STAN database for the year 1981. The variable draws on data from 15 sectors, illustrated in Table 5.2. Sectors such as mining and quarrying, food products, wood, pulp and paper, rubber and plastics and metal products all showed levels of productivity above the median of the sample. In contrast, energy, leather, chemicals, non-metallic mineral products, basic metals, machinery and equipment, electrical equipment and transport were relatively unproductive. Data on regional shares of employment by sector were taken from the Spanish Industrial Survey (*Encuesta Anual Industrial 1980-1983*), and averaged for 1980-1983. As in Chapter 3, this measure thus provides an average measure of regional competitiveness. Although this is not the only way of measuring a region’s reliance on competitive sectors, the measure has an important advantage over measures of trade. Measures such as export shares of

production or export/import measures incorporate the effects of trade protection, and thus do not fully capture international competitiveness.¹¹⁷

Table 5.2. Sector productivity in Spain (1981) and Argentina (1993)

Spain		Argentina	
Sector	Productivity	Sector	Productivity
Mining of energy	52.1	Mining of energy	61.9
Mining except energy	72.8		
Food and tobacco	73.8	Food and tobacco	28.9
Textiles and textile products	67.6	Textiles and textile products	18.9
Leather, leather products	55.0	Leather, leather products	15.1
Wood and wood products	89.4		
Pulp, paper and publishing	99.9	Paper and publishing	30.1
Chemicals and chemical products	59.7	Chemicals and chemical products	61.9
Rubber and plastic products	70.1	Rubber and plastic products	62.9
Other non-metallic mineral products	62.1	Other non-metallic mineral products	23.0
Basic metals	66.2		
Fabricated metal products	85.3	Fabricated metal products	21.6
Machinery and equipment	49.5	Machinery and equipment	26.9
Electrical and optical equipment	59.0	Electrical equipment	28.7
Transport	61.3	Transport	31.4
Median	67.6	Median	26.9

Note: For Argentina, productivity is in million pesos 1993 (Azpiazu et al. (2000), p. 22.

Regional specialization was measured using a regional Hirschmann-Herfindahl Index.

The index compares the distribution of employment in one region with a uniform distribution in which sector employment is equally spread across the region.¹¹⁸ It was computed on the basis of data on employment shares by sector provided by the Annual Industrial Survey for the year 1981 (Spanish Ministry of Industry and Energy, 1980-1983), averaged over the period 1980-1983. This was then merged with the individual

¹¹⁷ In the case of Spain, this has been shown to be the case (Bajo 1987).

¹¹⁸ The regional Herfindahl-Hirschmann Index is given by the following expression: $HHI_i = \sum S_r^2$ where S is the share of regional employment of sector r in a given region.

level data. The index reaches an upper bound of 1 when all employment in the region is concentrated in one sector, and takes the lowest value $1/R$ where R is the number of sectors, when regional employment is evenly distributed across all sectors. It is thus a continuous variable that reflects the theoretical concerns of the argument. Table A2 in the appendix to this chapter shows data used to construct the index.

Because the data do not distinguish between industry of employment, it is difficult to test the effect of regional features among individuals employed in losing industries. The analysis uses a (blunt) measure of occupation included in the survey as a control variable. A dummy was created to sort individuals according to whether they were likely to be more or less at risk in the labour market. A first category (taking on value 1) includes those most at risk, and comprises employers in industry and services (in both large and small companies), self-employed in industry and services, foremen in industry and services, skilled workers in industry and services and unskilled workers in industry and services. The reference category (taking on value 0) includes those presumed less at risk as a result of liberalization, and comprises employers in agriculture, agricultural workers and liberal professions. It also comprises those whose preferences are ambiguous, and mostly include public sector workers (middle and high level cadres in the administration, middle and high level executives in private companies, clerks and commerce workers).

In addition, the following control variables were included: age, gender, education, income, a variable for being unemployed and another for attitudes towards the role of unions in the democratic transition.¹¹⁹ The reconversion in Spain dealt a heavy blow to unions, and levels of support for the reconversion could be driven by a desire to oppose

¹¹⁹ Education takes value 0 if individual has less than primary school education or cannot read, 1 if primary school/vocational training, 2 secondary school, 3 tertiary education or technical education. "Unemployed" takes value 0 if the individual is a student, is retired or a housewife, 1 if employed and 2 if unemployed.

the decline of unions, who had also been key actors in the political transition. This indicator asks respondents to rank social actors in their role in bringing about a peaceful transition to democracy (with value 1 ranking unions as very important and 7 as not very important). A measure of population is also included to address concerns that specialisation correlates with industrialised and thus more populated regions.

Table 5.3. Distribution of independent and dependent variables in Spanish regions, 1983

Region	Competitiveness	Specialization	Support for employment	Support for modernizing
Andalusia	68.31	0.13	55.2	44.7
Aragon	66.72	0.08	22.2	77.6
Asturias	63.82	0.19	85	15
Baleares	64.96	0.12	28.5	71.4
Canarias	69.36	0.21	26.1	73.9
Cantabria	69.61	0.10	66.7	33.3
Castilla Leon	67.36	0.10	42.6	57.4
Castilla La Mancha	68.79	0.10	44.1	55.9
Catalonia	70.84	0.10	36	64
Valencia	68.01	0.09	50	50
Extremadura	70.25	0.19	17.2	82.7
Galicia	68.77	0.11	13.4	86.2
Madrid	63.03	0.09	31	69
Murcia	71.29	0.14	20	80
Navarra	70.39	0.09	12.5	87.5
Basque Country	67.48	0.11	41.7	58.3
Rioja	71.2	0.12	22.2	77.8
Median	68.78	0.11		

Note: Figures in the last two columns are in percentages.

Table 5.3 illustrates the relatively wide variation in the main explanatory variables across the sample of regions. Andalusia, Asturias, Aragon, Baleares, Castilla-Leon, Valencia, Madrid and the Basque Country show relatively low levels of competitiveness. In turn, Canarias, Cantabria, Catalonia, Murcia and Navarra show high levels of competitiveness. Regions also varied in the level of specialisation. Asturias and Canarias were heavily specialised, while Andalusia, Murcia, Balearic Islands and Rioja

showed levels of specialisation above the median. Other regions such as the Basque Country and Galicia were relatively diversified, while regions such as Madrid and Aragon were even more diversified. Table 5.3 also shows that levels of support varied across uncompetitive regions in ways that are consistent with the argument: Asturias, for instance, was considerably more specialised than the Basque Country or Galicia, all three uncompetitive regions. Yet support for employment-friendly policies was significantly higher in Asturias. Section 5.3 discusses this in more detail.

5.2.1.1 Empirical specification

The following logistic model is estimated:

$$\text{Support for employment-friendly reconversion} = \alpha + \beta_1 \text{Regional competitiveness} + \beta_2 \text{Regional specialization} + \beta_3 \text{Regional specialization} * \text{Regional competitiveness} + \beta_4 X + \varepsilon$$

Where X represents a vector of controls. A first additive model tests the effect of *Regional competitiveness* on support for compensation. A second model tests the interactive effect of regional competitiveness and specialization. The expectation is that the coefficient for specialization should be positive, indicating that individuals in specialized regions with *low* levels of competitiveness support high compensation. The constitutive term for competitiveness is expected to be negative, indicating that individuals in competitive diversified regions prefer lower compensation. Expectations regarding the interaction coefficient between *Regional competitiveness* and *Regional specialization* are ambiguous, reflecting the fact that those in competitive specialized regions benefit from positive externalities but also face lower outside options.

5.2.1.2 Findings

Table 5.4 reports the findings for the logistic model. The results show that regional specialization and competitive condition support for employment-friendly reconversion across regions. All else constant, individuals in uncompetitive and specialized regions are more likely to support employment-friendly measures than similar individuals in diversified regions.

Column 1 reports results for the additive model. On its own, regional competitiveness appears to have no statistically significant effect on support for employment-friendly reconversion. Being employed in an industry at risk is also positively associated with support for employment-friendly reconversion. Control variables behave mostly as expected. Greater income and education are negative and significantly associated with levels of support, while being a female and being unemployed are positive and significantly associated with levels of support. Union membership is consistently associated with greater support as well.

The interactive specification in column 2 provides evidence in support of the theoretical expectations. The coefficient estimates show that higher regional specialisation is positively related with support for employment-friendly reconversion and that this effect is more pronounced, as indicated by the interaction term, in less competitive regions.

The constitutive term for *Regional specialisation* is positive and significant, indicating that specialised and uncompetitive regions are associated with higher levels of support.

This provides clear evidence in support of the theoretical expectations. However, predictions about individuals in competitive regions are less clear. The estimates indicate that *Regional competitiveness* is positively associated with support for employment-friendly measures, and this effect is greater among diversified regions.

Given the ambiguous predictions of the argument, this suggests that the positive

externalities of specialisation matter more than the limited outside options associated with it.

Table 5.4. Determinants of support for employment-friendly reconversion, Spain, 1983

	1	2
	Additive	Interactive
Specialisation	0.04*	4.07**
	(0.03)	(0.91)
Competitiveness	0.02	0.66**
	(0.04)	(0.15)
Specialisation*Competitiveness		-0.06**
		(0.01)
Age	0.00	0.00
	(0.01)	(0.01)
Gender	0.64**	0.64**
	(0.17)	(0.17)
Industry at risk	0.32**	0.32**
	(0.15)	(0.15)
Education	-0.29**	-0.28**
	(0.12)	(0.12)
Employment status	0.27*	0.26*
	(0.14)	(0.15)
Income	-0.24**	-0.26**
	(0.07)	(0.07)
Union	0.13**	0.12**
	(0.04)	(0.04)
Population	0.04**	0.04**
	(0.02)	(0.02)
Constant	-2.55	-46.46**
	(2.43)	(10.03)
Observations	868	868

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

5.2.2 Analysing preferences for compensation in Argentine regions

A similar analysis was carried out for Argentine regions. The survey used in the analysis was fielded in September 1993 to a population of 1226 national adults, and data are available from the Roper Centre for Public Opinion Research.¹²⁰ Like for Spain, the survey was fielded at a time when trade and productive restructuring were already underway, but had not reached peak levels of unemployment. It is thus likely to provide a conservative estimate of preferences for compensation. Unfortunately, it draws on a

¹²⁰ The survey is ARROMER1993-TOP17, available from <http://www.ropercenter.uconn.edu>.

limited sample of regions. The survey was fielded in major urban agglomerations in 8 of the 24 regions: the Federal Capital, Buenos Aires province, Santa Fe, Mendoza, Cordoba, Tucuman, Corrientes and Rio Negro.¹²¹ Admittedly, this limits the sample of regions for comparison. However, to the extent that the theoretical argument focuses on alternative employment within manufacturing activities, comparing regions with very low industrial densities is not useful. If the logic of the argument holds, it should hold first and foremost in regions that have a fabric of industry. Indeed, low levels of competitiveness in many of the more peripheral regions reflect the *absence* of industry in the region, as many regions are either heavily reliant on primary agriculture or on extractive industries such as mining, as is the case in the Patagonian region of Neuquen. However, the regions available for comparison vary significantly on the two main explanatory variables (competitiveness and specialisation), which also makes it possible to merge regional and individual level data. A related caveat is that population size correlates with industrial density. To address this, a measure of population is included in the analysis.

The dependent variable

Preferences for compensation were measured using an item tapping into individual support for restructuring which is relatively similar to the one in the Spanish survey. It asks respondents the following question: “What is best: that the state support national industry for its growth, or that the state develop a policy of economic openness to force firms to become more efficient and competitive vis-à-vis the rest of the world?” The variable was recoded so that the first category takes on value 1, the second value 0. Like above, the item makes clear the costs of either option.

¹²¹ The urban agglomerations are: Bahia Blanca (Buenos Aires province), Rosario (Santa Fe), Mendoza (Mendoza), Cordoba (Cordoba), Tucuman (Tucuman), Corrientes (Corrientes), and General Roca (Rio Negro).

The independent variables

Like for Spain, the measure of regional competitiveness is a weighted sum of sector productivities, where the weight is the share of regional employment in the sector. For Argentine regions, data on productivity are taken from Azpiazu et al. (2000), who provide measures for the year 1993. Data by sector is only available for the following 10 sectors: food, textiles, leather, paper, chemicals, rubber and plastics, non-metallic minerals, metal products, electrical equipment and transport.¹²² Table 5.2 shows data on sector productivity for Argentine regions. Sectors with high levels of productivity are those with values above the median of the sample for 1993 and include: chemicals, non-metallic minerals, paper, basic metals, machinery and equipment. Unproductive sectors are textiles, leather, transport and metal products. The structure of productive and unproductive sectors is different from that in Spain under reconversion. Although not available from Azpiazu et al. (2000), the basic metals sector was among the more productive sectors in Argentina (Etchemendy 2011). This is consistent with what recent research identifies as losers and winners of liberalization in Argentina (Etchemendy 2011). This measure also cuts across levels of trade protection across industries: both basic metals and the transport sector were heavily protected in Argentina, and yet the latter was relatively unproductive. The shares of regional employment were computed on the basis of data from the Argentine National Economic Census for the year 1984. Data on regional employment in Argentine industries is available for 1984 and 1994 by the Argentine National Statistics Bureau (INDEC). However, data for 1994 is likely to reflect the significant rise in unemployment that peaked in early 1995. For this reason, data for 1984 is used.

¹²² In Azpiazu et al (2000), metal products and basic metals are aggregated into one. Data for wood is also missing.

Regional specialization is measured using a regional Hirschmann-Herfindahl Index. The index was computed with the same data on employment shares described earlier, provided by the Argentine National Economic Census (also for the year 1984). It was then merged with the individual level data. Table A1 in the appendix shows data used to construct the index.

Once again, measuring employment across industries more or less at risk is problematic, as the data do not provide information on industry of employment. A dummy variable sorts individuals according to whether they were likely to be more or less at risk in the labour market and is used as a control variable. A first category (taking on value 1) includes those most at risk, and comprises businessmen and CEOs in industry and services, self-employed in industry and services, skilled workers in industry and services and unskilled workers in industry and services. The reference category (taking on value 0) includes those presumed less at risk as a result of liberalization, and comprises technicians, liberal professions, and those in public employment. Also included as control variables are age, gender, education, income and a variable for being unemployed.¹²³

Table 5.5 provides information on the distribution of the independent and dependent variables for the regions in the sample.

¹²³ Education takes value 0 if individual has less than primary school education or cannot read, 1 if primary school/vocational training, 2 secondary school, 3 tertiary education or technical education. “Unemployed” takes value 0 if the individual is a student, is retired or a housewife, 1 if employed and 2 if unemployed.

Table 5.5 Distribution of independent and dependent variables in Argentine regions, 1993

Region	Regional competitiveness	Regional Specialization	Support for industry	Support for trade
Capital Federal	25.6	0.09	64.3	35.7
Buenos Aires	31.9	0.10	46.9	53.1
Cordoba	24.2	0.19	62.1	37.9
Corrientes	11.1	0.11	33.9	66.1
Mendoza	15.1	0.09	34.1	65.9
Rio Negro	30.5	0.30	55.1	44.9
Santa Fe	24.5	0.14	58.1	41.9
Tucuman	23.2	0.44	51.0	49.0
Median	25.6	0.18		

Note: The median for specialisation is computed using data for the 24 Argentine regions.

5.2.2.1 Findings

The analysis replicates the one above and evaluates the relationship between regional characteristics and support for measures that support national industry with a binary logistic model. The results, reported in Table 5.6, show that individuals in uncompetitive and specialized regions are more likely to endorse measures that support the national industry than similar individuals in diversified regions. Unexpectedly, the additive model in Column 1 shows that regional competitiveness is associated with greater levels of support. Education is negative and significantly associated with levels of support, while being female is positive and significantly associated with support. Income sheds a negative coefficient throughout.

Table 5.6 Determinants of support for national industry, Argentine regions, 1993

	1	2
	Additive	Interactive
Specialisation	-0.01 (0.01)	0.19** (0.06)
Competitiveness	0.07** (0.02)	0.23** (0.05)
Specialisation*Competitiveness		-0.01** (0.00)
Industry at risk	0.19 (0.21)	0.17 (0.21)
Age	-0.07 (0.07)	-0.07 (0.07)
Gender	0.44** (0.16)	0.47** (0.17)
Education	-0.29** (0.12)	-0.34** (0.13)
Unemployed	-0.61* (0.35)	-0.63* (0.35)
Income	-0.17** (0.07)	-0.17** (0.08)
Population	-0.03** (0.01)	-0.06** (0.01)
Constant	-0.25 (0.48)	-3.34** (1.02)
Observations	642	642

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

The findings for the interactive specification, shown in column 2, confirm the results for Spain and provide clear evidence in support of the theoretical expectations. The coefficient estimates indicate that *Regional specialisation* is positively related with levels of support for national industry, and this effect is more pronounced in uncompetitive regions. Like for Spain, however, the findings show that *Regional competitiveness* is positively associated with levels of support to a greater extent among diversified regions. Given that the theoretical claim regarding losing individuals in competitive and specialized regions was not unambiguous, this constitutes an interesting empirical result. The following sections complement the statistical analysis and qualitatively illustrate how the interaction of regional competitiveness and specialization can play a role in shaping demand for compensation.

5.3 Studying preferences in selected regions

The following section provides an in-depth examination of the dynamics of support for compensation in regions selected according to the main explanatory variables described above. Mapping regions according to the main explanatory factors provides insights on the extent of variation that is not accounted for by competitiveness only. Analytically, focusing on regions that do and do not conform to theoretical expectations makes it possible to gain leverage over how the joint effect of competitiveness and specialization may impact preferences over employment-friendly restructuring (Vreeland 2003a).

Table 5.7 maps regions in Spain and Argentina according to the measures of regional competitiveness and specialisation described above. It shows that many regions with low levels of regional competitiveness (below the median) showed high levels of support for employment-friendly reconversion. In Spain, regions such as Asturias, Cantabria or the Basque Country, all heavily industrialised, exhibited very high levels of support relative to regions such as Catalonia or Canarias, both relatively competitive regions (with values above the median). Unsurprisingly, Spanish regions where the proportion of layoffs due to reconversion was relatively high (above the median, set at 1.67) were also those with high levels of support for compensation. The share of layoffs due to reconversion was greatest in Asturias (12.45%), the Basque Country (8.63%), Cantabria (5.8%) and Galicia (almost 4%). However, not all regions with low levels of regional competitiveness exhibited high levels of support. Much more specialised than the Basque Country, Galicia or Cantabria, Asturias exhibited significantly higher levels of support for employment-friendly reconversion. In

turn, Catalonia and Andalusia were relatively competitive and appeared to vary significantly in levels of support.

While no comparable data on layoffs across sectors by region exists for Argentina, levels of support in Argentine regions show a similar pattern. Since many agricultural regions have little industry to speak of, computing the median yields a very low – and potentially meaningless – cut off. Thus, the sum of the mean and one standard deviation is used instead.¹²⁴ Cordoba, Santa Fe and Tucuman showed levels of regional competitiveness below the cut-off, and relatively high levels of support for the protection of national industry as opposed to free trade. However, while Mendoza and Cordoba were both relatively uncompetitive, levels of support were significantly higher in Cordoba, which was also more specialised.

¹²⁴ Both cut-offs reflect all the regions in the sample, not just those for which survey data is available.

Table 5.7 Competitiveness, specialisation and support for employment-friendly restructuring

Spain	Competitiveness	Layoffs 1981-88	Specialisation	% For avoiding unemployment
Andalusia	68.31	1.67	0.13	55.2
Aragon	66.72	0.37	0.08	22.2
Asturias	63.82	12.45	0.19	85
Baleares	64.96	2.44	0.12	28.5
Canarias	69.36	0.64	0.21	26.1
Cantabria	69.61	5.8	0.10	66.7
Castile-Leon	67.36	0.12	0.10	42.6
Castile-La Manche	68.79	0.02	0.10	44.1
Catalonia	70.84	1.09	0.10	35
Valencia	68.01	2.12	0.09	50
Extremadura	70.25	0.03	0.19	17.2
Galicia	68.77	3.88	0.11	13.4
Madrid	63.03	2.73	0.09	27.9
Murcia	71.29	0.09	0.14	20
Navarra	70.39	2.52	0.09	12.5
Basque Country	67.48	8.63	0.11	41.7
Rioja	71.2	0.24	0.12	22.2
Median	68.31	1.67	0.11	
Argentina				% For protection of industry
Capital Federal	25.6		0.09	35.7
Buenos Aires	31.9		0.10	46.9
Cordoba	26.0		0.19	62.1
Corrientes	11.1		0.11	33.9
Mendoza	15.1		0.09	34.1
Rio Negro	30.5		0.30	55.1
Santa Fe	24.5		0.14	58.1
Tucuman	23.1		0.44	51
Median	26.4		0.18	
Catamarca	9.2			NA
Chaco	25.3			NA
Chubut	13.1			NA
Entre Rios	24.3			NA
Formosa	13.7			NA
Jujuy	16.5			NA
La Pampa	14.4			NA
La Rioja	15.8			NA
Misiones	13.4			NA
Neuquen	6.3			NA
Salta	7.4			NA
San Juan	29.5			NA
San Luis	13.5			NA
Santa Cruz	22.4			NA
Santiago Estero	12.4			NA
Tierra Fuego	23.2			NA
Median	16.6			
Aver. + St dev.	26.4			

Table 5.8 summarises the above information and divides 25 available observations into four types: regions with high and low competitiveness with high and low levels of

support for employment-friendly reconversion or national industry (high levels of support are set at above 50% for both the Spanish and Argentine surveys). The diagonals inside the cells sort regions by level of regional specialisation. Table 5.8 shows that 52% (13 out of 25) of the observations are consistent with the argument that individuals in regions with low (high) levels of competitiveness support greater (lesser) employment-friendly restructuring. But in 11 of the 25 regions the relationship between regional competitiveness and levels of support did not conform to expectations. Table 5.8 also shows that most regions with low competitiveness and low levels of support for employment-friendly restructuring were also not very specialised. Despite the few observations, the upper-right quadrant shows that most uncompetitive regions where support was high were also specialised. In turn, those regions with high levels of competitiveness that exhibited low support also exhibited greater variability – some of them were specialised, others were not – while those competitive regions where support was higher were also highly specialised. This appears to speak against the claim that individuals in such regions should support low compensation. However, the low number of data points in the bottom-right quadrant makes it difficult to establish this with certainty.

These patterns suggest that levels of competitiveness may not be sufficient to explain these observations. They are also slightly at odds with explanations that emphasise the role of the macroeconomic environment in driving support for market reforms (Baker 2010). In a prominent study, Baker (2010) argues that consumer interests drive mass support for market reforms in Latin America. While as owners of assets (or producers) citizens may be harmed by reforms, as consumers they may benefit from them. The extent to which the effects of market reforms are visible determines the relative weight of consumer motivations versus producer motivations. The effects of trade liberalisation

– which increased the availability, affordability and quality of goods – in Latin America were highly visible, and drove support for structural reforms that would otherwise have elicited strong opposition (Baker 2010: 19-56). Arguably, however, the different levels of support for free trade in Argentina suggest that despite the net positive effect of reforms, distributive considerations played a role in driving support for compensation.

Table 5.8 Support for employment-friendly restructuring in Argentine and Spanish regions according to the main explanatory variables

	Low support	High support	
Low competitiveness	<i>Low specialization</i> Basque Country Madrid Galicia Valencia Castile-Leon Castile-Manche Corrientes Mendoza	<i>Low specialization</i> Santa Fe	13
	<i>High Specialization</i> Balearic Isl.	<i>High Specialization</i> Asturias Cordoba Tucuman	
High competitiveness	<i>Low Specialization</i> Catalonia Aragon Navarra Federal Capital Buenos Aires	<i>Low Specialization</i>	11
	<i>High Specialization</i> Canarias Extremadura Murcia Rioja	<i>High Specialization</i> Andalusia Rio Negro	
	18	6	25

To explore this, this section provides an in-depth examination of regions selected from each of the above cells, for both Spain and Argentina. In order to enhance comparability between regions, the cases selected from each cell were among the more industrialised

regions, and are indicated in bold.¹²⁵ The cases explored below illustrate that regional features such as regional competitiveness and specialization jointly mattered in shaping patterns of demand. Together, they closely reflect the expectations in Table 2.1 in Chapter 2. The selection also makes it possible to unpack the role of income and risk in shaping compensation. The cases of Asturias and Cordoba (top right) plausibly set an upper bound on the extent to which risk plays a role in shaping demand for employment-friendly reconversion. Individuals employed in losing industries in such regions faced negative income and very high risk. Regions in the top left quadrant (above the cell diagonal) constitute cases where risk played a somewhat smaller role. Individuals in losing industries in the Basque Country and Mendoza faced income losses from trade and thus benefitted from compensation, but faced somewhat lower risk. In turn, the cases of Catalonia in Spain and Buenos Aires province in Argentina (bottom left) set a minimum bound on the extent to which risk is likely to play a role in shaping demand, as trade losers in such regions faced negative income returns, but faced very low risk of unemployment in the event of a shock. Finally, regions in the bottom right quadrant of Table 5.8 constitute cases in which trade losers faced negative income returns and some risk. In these cases, risk plays a greater role for individuals employed in losing industries. In fact, it may even lead to high levels of support for compensation at high levels of competitiveness.

¹²⁵ A study of Rio Negro would be interesting and complete the picture. However, for reasons of space it is left for future research.

5.3.1 Spain: Asturias and the Basque Country, Andalusia and Catalonia

5.3.1.1. Uncompetitive regions: why was demand for employment-friendly reconversion in Asturias greater than in the Basque Country?

Industrial workers in Asturias had strong reasons to demand compensation. Asturias was among the most unproductive regions in the country. Historically a coal and mining region, industry in Asturias revolved traditional sectors such as mining and steel, both of which faced severe excess capacity and, especially steel, increasing foreign competition in the context of the common market. In Asturias, integrated steel made up 26% of regional employment in industry, common steel accounted for almost 9% and shipbuilding for over 5%.¹²⁶ Mining made up 30% of regional employment in 1981.¹²⁷ The rest was accounted for by the food industry (8%), non-mineral metals (5%), wood (4%), machinery and equipment (2%), textiles (2%), chemicals (1%), home appliances (1%) and paper (1%).¹²⁸

Reconversion in integrated steel was announced in late 1983. Decrees 1853/1983 and 8/1983 announced workforce reductions in two of the three existing hot-rolling mills, located in Asturias (*Ensidesa*) and in the Basque Country (*Altos Hornos de Vizcaya*). It also channelled a series of subsidies to modernize Ensidesa and AHV, at the expense of the blast furnace in Valencia (*Altos Hornos del Mediterraneo*, AHM), whose viability depended on the construction of a hot-rolling mill without which the plant would become obsolete under European integration (Navarro 1989). Restructuring in steel entailed production cuts of 20% and a reduction of the workforce of over 20% by late

¹²⁶ The steel sector comprised the three sub-sectors of integrated steel, common and special steel.

¹²⁷ In the Spanish data, mining is classified as secondary sector (industry), though it was not exposed to foreign competition.

¹²⁸ Data are for 1981 and are computed from the National Annual Survey 1980-1983 (Spanish Ministry of Industry and Energy). The numbers do not add to 100% because other very small shares of employment are accounted for by sectors such as leather or rubber, and/or because they do not include manufacturing “not elsewhere classified”.

1984. This meant going from 42837 in 1980 to 33727 jobs in 1984 and eventually to 25936 by 1990 (Fanjul and Maravall 1987). In turn, in 1983 a new reconversion plan for the shipbuilding sector for the period 1984-1986 entailed reductions of 26% in production among the small shipyards and 58% among the large yards (Fanjul and Maravall 1987).¹²⁹ Although the bulk of employment cuts was carried out in 1987, the plan contemplated reductions in employment of 46% for the small yards and 41% for the large yards. These measures heavily affected workers in the area of the Bay of Gijon, in the region's capital, Oviedo, where four small shipyards employed almost 3200 workers. Of them, 1454 were employed by the public shipyard Juliana (*Juliana Constructora Gijonesa*), while the rest were distributed between the three smaller private shipyards, *Duro Felguera* (639 workers), *Maritima del Musel* (501) and *Cantábrico y Riera* (579).¹³⁰ *Cantábrico y Riera* closed in 1984, while *Duro Felguera* and *Maritima del Musel* merged into what came to be known as *Naval Gijon*, and *Juliana* was eventually privatized. Their inclusion in the Reconversion Society for Small and Medium Shipyards (SORENA) led to a series of employment cuts that resulted in 3000 job losses in 1984.

Workers in steel and shipbuilding, as well as in associated auxiliary sectors, faced very dim prospects. The specialization of the region on unproductive sectors had stark implications for workers' chances of reemployment. As emphasised by a former worker and member of the socialist union UGT at *Duro Felguera* in the context of the merger of the latter and *Maritima del Musel* in Asturias:

“When dealing with excess workers, except for *Cantabrico y Riera* [which closed], in the rest of the shipyards we tried to focus dismissals on those above 52 or 54 so that they could go straight into retirement... That was the case for most of those who subscribed to the Employment Promotion Funds [in the sector]. Others found reemployment in

¹²⁹ Own calculations based on data provided by Fanjul and Maravall (1987).

¹³⁰ *El Pais*, “Reconversion plans in shipbuilding enhance social conflict”, November 4, 1984. *El Pais*, “Conflict between workers from the Naval and police in Gijon”, June 29, 1984.

random firms, including arms companies. But the biggest issue in the end to deal with excess workers was with Ensidesa, which faced pressures to take on workers – they were told, “take these workers, otherwise no one is going to take them”. In Asturias, the monoculture was so great that there were no possibilities of reemployment. Even Hunosa [the public mining company] was shedding labour... We also tried to put people in Hunosa. The monoculture was excessive.”¹³¹

When the sector was declared under reconversion in 1983, large blocs of voters in Asturias opposed the reconversion measures. The workforce reductions contemplated by the reconversion plan mobilised workers in the shipyards concerned about the lack of employment opportunities in the region in demand of reindustrialising measures.¹³² With a population of over 250000 and 24000 unemployed, the city of Gijon and surrounding areas were characterized by salient episodes of protest.¹³³ Not surprisingly, when asked to give their opinion on industrial reconversion, 85% of voters in Asturias stated that they would prefer that the government avoid the rise of unemployment at all costs, even if this implied greater financial losses (see Table 5.7 above).

More specifically, it was the *absence* of policies to address the effects of the monoculture that exacerbated social conflict in the region. Large demonstrations and general strikes took place throughout Asturias in 1983 and 1984 in protest for the lack of reindustrializing policies that would offset employment losses.¹³⁴ In November 1983, the regional parliament in Asturias requested that the region be declared an Area of urgent Reindustrialisation to “implement measures to mitigate the crisis that grips the region due to restructuring in shipbuilding and steel.”¹³⁵ Interviews with former workers in private and public reconverted firms in Asturias revealed that demands for unemployment insurance came second to those concerning the reallocation of workers.

¹³¹ Author’s interview with Eduardo Lafuentes. Madrid, March 8, 2012.

¹³² *El Pais*, “Strike of 30000 workers in protest for reconversion in shipbuilding”, October 29, 1983.

¹³³ *El Pais*, “Reconversion plans in shipbuilding enhance social conflict”, November 4, 1984.

¹³⁴ *El Pais*, “Reconversion plans in shipbuilding enhance social conflict”, November 4, 1984. *El Pais*, “Nuevas movilizaciones contra la reconversion industrial”, December 11, 1983.

¹³⁵ *El Pais*, “Asturias parliament demands solutions for crisis in the region”, March 1, 1983.

This included active labour market policies, but also investments that would ensure the economic viability of firms under reconversion. More particularly, they emphasized that the absence of active labour market policies led workers to protest in demand of measures that would facilitate employment.¹³⁶ In a region heavily specialised in uncompetitive activities, workers facing income losses as a result of restructuring faced very dim prospects of reemployment, and this drove demand for compensation.

In the Basque Country, by contrast, the adverse effects of liberalisation were arguably dampened by the region's diversified economy. Like Asturias, a large share of Basque manufacturing was accounted for by unproductive sectors. Indeed, sectors with low levels of productivity made up over 50% of regional employment in manufacturing. But employment in unproductive sectors was widely distributed over an array of economic activities. Thus, while 36% of employment was in steel and metals, machinery and equipment accounted for 10%, shipbuilding for 8%, home appliances (8%), food (4%), wood (5%), paper (5%), rubber and plastics (7%), non-metallic mineral products (3%), chemicals (3%) and textiles (2%). In addition to AHV in integrated steel, the Basque Country was home to many of the most traditional shipyards that had underpinned growth in the shipbuilding sector in the 1960s (Cerezo and Sanchez 1996: 196). The main public company in the sector, AESA (*Astilleros Españoles, S.A.*, or Spanish Shipyards), was born from the merger in 1969 of the private *La Naval*, in the Basque municipality of Sestao, the historic Euskalduna Shipyard on the left bank of the river Nervion in the northern province of Bilbao, and the public shipyard *Astilleros de Cadiz*,

¹³⁶ "In Asturias there was steel and shipbuilding, the private shipyards and the public shipyard, Juliana. In terms of union representation, we had two situations. In steel, Comisiones Obreras [the main Communist Union] accepted the Decree of Reconversion and Reindustrialization. In shipbuilding, it did not, not until [Ignacio Fernandez] Toxo kicked [Jose Manuel] Marin out in a Congress in Galicia in 1986 – from then on, Comisiones Obreras agreed to participate in the Employment Promotion Funds, which was the main instrument that we demanded to reallocate workers. That was the turning point in terms of participation in the EPF, which were designed to train workers and prepare for retirement, and also to reemploy." Author's interview, Madrid, March 8, 2012.

in Andalusia. With the merger, AESA became the fourth largest shipyard in terms of productive capacity worldwide. The 1970s oil shocks and the subsequent crisis it brought about, however, laid bare the problems affecting steel and shipbuilding, both of which exhibited strong trade deficits and suffered from severe overcapacity.

Reconversion in the large shipyards involved substantial capacity cuts and downsizing. In the small and medium shipyards, it involved a series of mergers that would lead to a drop in production capacity of 60% between 1984 and 1990 (Fanjul and Maravall 1987, Etchemendy 2011: 97). In the Basque Country, this amounted to a reduction of 3415 jobs, or 20% of total job losses in the sector.¹³⁷ A second and more severe wave of adjustment in integrated steel in 1986 paved the way for further capacity and workforce reductions (Del Castillo 1988, Pascual 1993).

Yet the existence of outside options arguably dampened the risk of unemployment and with it, demands for compensation. Levels of support for employment-friendly reconversion were substantially lower in the Basque Country than in Asturias. As depicted in Table 5.7, 41% of individuals surveyed in 1983 stated a preference for maintaining employment in reconverted sectors, versus 85% in Asturias. In contrast, 58% stated that the government should reform and modernize such companies even if employment was lost. Interviews carried out with former workers and members of Works Councils in AHV explicitly highlighted the role played by regional structure in offsetting labour market risk and dampening demands for compensation. The account of a former worker at AHV is illustrative in this respect:

“It is true that [there are] regions with an industrial monoculture that implies that workers in industries have no alternatives, if they close. We saw that from Euskadi [the Basque Country], where we have more diversified sectors than, for instance, Asturias. When one says, “There is an extra furnace: Asturias or Biscay?” What does Asturias have? It had mining, integrated steel and that’s it. The gross domestic product was there.

¹³⁷ *El Pais*, October 31, 1983. *El Pais*, “The remains of a shipwreck”, October 7, 1984

In Euskadi, we had considerably more: shipbuilding, aeronautical, an important banking sector... There was more diversification in industry, and you could tell it was easier, because of greater sector diversification, to reemploy workers than in Asturias, where they had very little. If you discounted integrated steel, you had mining, and mining was also not doing well. The government closed the furnace in Biscay because there were more possibilities of reemployment. Because of the greater diversification of industry in Euskadi compared to Asturias.”¹³⁸

Industrial reconversion nonetheless triggered opposition, and social unrest underpinned some of the most symbolic episodes of adjustment. At a regional level, reconversion led to a reduction of over 8% of its industrial workforce, the second highest after Asturias.

At the sector level, adjustment in integrated steel led to a reduction of 22.6% of total layoffs due to reconversion (5422 of a total of 23993).¹³⁹ In the shipbuilding sector, downsizing involved the loss of over 4000 jobs in the public shipyards, equivalent to 17.4% of total downsizing in the region. Of these, 1297 resulted from the closure of Euskalduna in 1987, one of the most traumatic events of the reconversion period.¹⁴⁰ The workers of the yard mounted fierce resistance from October to December 1984, blocking streets, occupying Bilbao’s banks and government offices and clashing with national police on a daily basis.¹⁴¹ Yet even during such episodes, the existence of outside options arguably diluted the demands of protesters. As emphasised by a former worker at *La Naval*, one of the traditional shipyards in the region:

“The main concern has always been employment, stable jobs. If we wanted to be in the market, we had to adjust to the rules that governed the market and be competitive, and this meant not only incorporating technology to jobs, but also letting go of jobs. But none of this has been easy and *gratis*. There have been fights with dead people and others who have lost an eye in this. Sometimes – for instance with Euskalduna – mayors would position themselves in favour of industry and employment, but in the moment of truth they sided with the central government. Sometimes this also occurred between us [the union]. [This was due to] the variety of industry in the region in the eighties. Until

¹³⁸ Author’s interview with Nestor Alvarez, Bilbao, 29 February 2012.

¹³⁹ Data on layoffs by sector is only available for the Basque Country, Asturias and Cantabria (Pascual 1993).

¹⁴⁰ Job losses in the small shipyards amounted to 2098, or 8.7% of total reconversion layoffs. Own calculations, based on data from Pascual (1993).

¹⁴¹ *El Pais*, “Barricades against shipbuilding reconversion in Bilbao”, October 4, 1984. *El Pais*, “General strike in Biscay against industrial reconversion”. November 11, 1984.

2000, one could choose in Euskadi... You tell yourself, I have reemployment, I can pull off 4 or 5 years... In that case, you resist, but you have [some sort of] continuation. And since there were possibilities of employment in the region... It was a different situation. If reconversion had happened today, things would have been very different”.¹⁴²

There were other reasons why demands for compensation were relatively dampened in the Basque Country despite the incidence of reconversion in the region. In contrast to Asturias (or Galicia), the Basque Country exhibited a very high density of small and medium size enterprises. Data on the number of industrial jobs per square kilometre across Spanish regions emphasise the relatively low density of SME in Asturias, estimated at 4.3 jobs per square km in 1980, relative to the Basque Country – with 43.2 jobs per square km.¹⁴³ In addition to measuring overall industrial density, the ratio is also likely to reflect the presence of small and medium size enterprises, since lower scores may capture the fact that employment is concentrated in a few areas. When asked about differences in regional structure, a former top policymaker remarked the following:

“The difference between the Basque Country and Asturias is that the Basque Country has a more dynamic industrial base, an entrepreneurship that is much more dynamic and a diversified industry. But not only more diversified, because adjustment in the Basque Country did not boil down to shipbuilding – all the big industry in Bilbao, with the oil crisis and processes of restructuring, was extraordinarily reduced and yet the whole industrial fabric, above all of the medium-sized enterprise, both in Biscay and in Guipuzcoa, is fairly concentrated – industry is diversified, but has a strong dependence on the metal industries, broadly understood. Proof of this is that it has endured adjustment much better. Why? Because the entrepreneurial, industrial and working culture in the Basque Country is very different from that of Asturias, which is marked by the culture of the mining areas, which resembles the agrarian culture to a greater extent than industry, and even in the manufacturing industry, such as steel, there was no dense industrial fabric strong enough to foster development independently of public aid.”¹⁴⁴

¹⁴² Author’s interview with Pedro Rodriguez, Bilbao, 29 February, 2012.

¹⁴³ The following relies on data assembled by Fernandez Cuesta and Fernandez Prieto (1999). Unfortunately, data on industrial density distinguishing between large and small and medium sized enterprises is not available for the period before 1990.

¹⁴⁴ Author’s interview, Madrid, March 7, 2012.

In sum, demand for compensation stemming from affected interests in the Basque Country reflected the existence of greater outside options. A dynamic and diversified regional economy dampened labour market risk in the wake of restructuring and diluted demands for compensation.

5.3.1.2 Competitive regions: why was demand for compensation in Andalusia greater than in Catalonia?

Industrial workers in Andalusia had arguably relatively little need for compensation. Reflecting the region's comparative advantage, a large share of workers was employed in agricultural sectors – both primary and secondary – that were key to regional productivity and growth. Together, the “agrofood complex” formed by primary agriculture and food industries accounted for 32% of total regional employment in 1979 (Roura 1980). Traditional industry was relatively underdeveloped. 18% were employed in industry compared to the 45% in the Basque Country in 1981. Within manufacturing, however, food industries made up almost 30% of regional employment, followed by transport (10%), textiles (9%), non-metallic mineral products (9%), metal products (6%), wood (6%), energy (4%), chemicals (3%), electrical equipment (3%), basic metals (2%), machinery (2%) and paper (2%).¹⁴⁵ Overall, the agrofood complex was a competitive sector that exported both unprocessed and processed products to Europe and the rest of Spain. Moreover, Andalusia's food industries were among the few net exporting industrial sectors in the region. Regional specialisation in the agrofood sector had enabled food industries to benefit from economic externalities that translated into high productivity levels (Roura 1980: 413).

Nonetheless, a few traditional industries, such as shipbuilding, the production of metal products, chemicals and machinery, faced severe import competition and were in bad

¹⁴⁵ Data are computed for 1981.

shape. These unproductive sectors accounted for almost one quarter of employment in industry, and were relatively concentrated in the provinces of Cadiz (shipbuilding), Huelva (shipbuilding and chemicals), Seville (shipbuilding), and Gibraltar (basic metals). The shipbuilding sector, in particular, was heavily concentrated in the Bay of Cadiz, which included three large public shipyards (AESAs-Puerto Real, AESA-Cadiz and Bazan, located in San Fernando, which produced military ships), and Seville, which included AESA-Seville. The reconversion plan announced in 1984 mandated that AESA-Cadiz focus exclusively on repairing ships, AESA-Puerto Real and AESA-Seville focus on building new ships, while Bazan would keep on building warships and commercial ships. This led to a number of factory closures and a 50% cut in capacity, and entailed a very large reduction of the workforce in the large shipyards. In Andalusia, the reconversion plan entailed a reduction of 3000 jobs out of a total of almost 17000 announced by the plan in 1984 for the whole of shipbuilding sector in Spain.¹⁴⁶

Workers in industries affected by reconversion faced dim prospects in the event of job loss. The region's heavy specialisation in agriculture and food industries entailed economic risks. Although productive and, on average, exporting, the agrofood complex – and in particular, the food industry – faced problems too. The sectors that made up the food industry were very heterogeneous, and not all were equally productive. Three industries within the food industry – oils and vegetable fats, alcohol and wines, and sugar – were highly productive and net exporters, while the rest – mainly dairy and meat – were largely unproductive and imported the majority of goods (Roura 1980: 413). This partly explained the low growth in regional value added of the food industry as a whole (5%). In addition, agricultural commodity industries were exposed to high levels of price volatility due to seasonal variations in production. This hardly constituted a solid basis

¹⁴⁶ *El Pais*, October 31, 1983. *El Pais*, “The remains of a shipwreck”, October 7, 1984. Note that the final number was lower, as indicated in Table 5.3.

on which to reemploy workers from unproductive industries in the event of job loss.

Given the region's specialisation, a cyclical decrease in regional competitiveness could lead to economic downturn, severely limiting reemployment prospects.

Other reasons linked to the region's specialisation also exacerbated labour market risk for those affected by restructuring. Core manufacturing sectors such as shipbuilding and machinery or chemicals had hardly any backward or forward linkages with other industries in the region. Given the regional specialisation on food, such sectors relied on foreign imported inputs (international and national) necessary to their production. For instance, only 30% of intermediate inputs in the shipbuilding sector were purchased from sectors in the region (mostly machinery). The absence of backward articulation of the shipbuilding sector in Andalusia "was very important and must be taken into account because of its consequences for the regional labour market as well as for computing exports of final products" (Roura, 1980: 421).

When the shipbuilding sector was declared under reconversion, workers across Cadiz, Puerto Real, San Fernando, Huelva and Sevilla mobilised demanding "reindustrialising measures as an alternative to the reduction in employment contemplated by the reconversion plan".¹⁴⁷ In response to the growing levels of dismissals in one of the most affected provinces, the local government in Cadiz demanded that the central government declare Cadiz an Area of Urgent Reindustrialisation.¹⁴⁸ This was echoed in mass levels of support for compensation. As shown in Table 5.1, 55% of individuals surveyed in Andalusia preferred the government to avoid the rise of unemployment at all costs in the wake of reconversion. In competitive regions such as Andalusia, positive externalities

¹⁴⁷ *El Pais*, "Workers in the shipyards mobilized yesterday in defense of their jobs", November 5, 1983. *El Pais*, "Unequal incidence in Andalusian provinces: Cadiz province most affected by the protest against shipbuilding reconversion", July 13, 1984.

¹⁴⁸ *El Pais*, "Cadiz town hall demands an area of urgent reindustrialisation" November 4, 1984. Such measures will be explained in detail in Chapter 6.

and high competitiveness were arguably not enough to dampen labour market risk. Specialization implied greater vulnerability to a possible decrease in regional competitiveness, and led individuals to demand some level of compensation.

Like Andalusia, industrial workers in Catalonia had relatively little need for compensation. Catalonia had a strong tradition in industry, and was a dynamic economy with a strong fabric of small and medium sized firms. Compared to the rest of Spain, Catalan industry was relatively productive. The food and auto sector and, to a lesser extent, chemicals, were highly productive and were among the net exporting sectors of Catalan industry (Bajo 1987). Also productive but less exposed to international competition were rubber and plastics and paper. Less productive were textiles, machinery and home appliances. Catalonia's industrial structure was significantly diversified (Callejon and Quevedo 2000). Although the region had historically concentrated much of the production of textiles, which made up 20% of regional employment in industry in 1981, employment was distributed between metal products (11%), chemicals (9%), machinery and equipment (7%), home appliances (7%), transport (8%), food (10%), wood (5%), paper (5%), rubber (5%) and non-metallic mineral products (5%). Regional diversification had contributed to Catalonia's dynamic economy, and had enabled some of the more productive sectors to benefit from knowledge spillovers across some of the more technological sectors – such as the auto sector and chemicals (Callejon and Quevedo 2000).

The diversified and dynamic nature of Catalan industry did not prevent it from experiencing reconversion in some of its more traditional sectors. Textiles, in particular, were in bad shape. It had been hard hit by increasing imports “at a time of falling demand due to the oil crisis, which had a huge impact, and together with gradual liberalization – above all, EU membership was under way – a very strong opening of the

economy was expected.”¹⁴⁹ Introduced in 1981, the Plan for Textiles Reconversion initially sought to reduce excess capacity, scrap old machines and substitute them with new ones, and from 1985, also introduced design and fashion. Because of the fragmented nature of the sector – largely made up of small and largely family-run businesses – reconversion in textiles was based on an “open” plan to which firms could voluntarily sign up. Reconversion entailed significant capacity cuts and very large reductions in employment. The effects of restructuring were concentrated in areas to the north and west of Barcelona, where small and medium sized textile companies were mainly located.¹⁵⁰ With the exception of clothing, which was relatively dispersed across the country, synthetic fibre, spinning and finishing (such as dyeing) were concentrated in the region.¹⁵¹

Workers affected by liberalisation in the textiles industry faced outside options. Although the shadow of unemployment loomed large for such workers, the region’s diversified industry offered opportunities for reemployment. Technological modernisation in textiles meant that firms “needed to train few people. [Firms] got rid of older workers who would have more difficulty learning, and kept the younger workers.”¹⁵² The general impression among those interviewed was that those that were not generally had little trouble finding jobs in other sectors, because the specificity of skills was not that high and young people could be trained almost anywhere. Given the relatively low-skilled profile of workers in the textiles sector, this gained relevance in the period before 1985, when the focus on labour reduction was most pronounced. Catalonia could face the “industrial and technological challenge” of reconversion “because it [was] a very industrialised area, with an industry that was embedded in the

¹⁴⁹ Author’s interview, Madrid, April 3, 2012.

¹⁵⁰ These included the counties of the Baix Llobregat, Mataro, Igualada and Valles Oriental.

¹⁵¹ They were fundamentally concentrated in Catalonia, and to some extent in Valencia, and Castilla-Leon. There were also isolated firms in the Basque Country and Cantabria.

¹⁵² Author’s interview, Madrid, April 3, 2012.

social fabric”.¹⁵³ Other reasons contributed to minimising the risks of unemployment of those that lost their jobs. The textile population was on average quite old, and this enabled firms that reconverted to resort to early retirement schemes, so that “the social aspect of restructuring was significantly minimized”.¹⁵⁴

Industrial reconversion in textiles nonetheless triggered some demands for compensation. The area of the Baix Llobregat, heavily reliant on small textiles firms, was hard hit, and in June 1984 workers demanded that it be declared an Area of Urgent Reindustrialisation.¹⁵⁵ But in general, social conflict did not enjoy the support of the broader population as it did in Asturias or Andalusia, and Catalonia was not the scene of mass protests. Despite heavy job losses in one the region’s historic sectors, reconversion was hailed as leading to high investment and growth, and the region’s ability to absorb shed labour celebrated.¹⁵⁶ Not surprisingly, this was echoed in levels of support for reconversion. As shown in Table 5.1 above, 65% of Catalan voters declared their support for the reform and modernisation of losing sectors, even if this meant the loss of jobs. Regional competitiveness and a diversified industrial structure contributed to minimising the negative effects of reconversion, dampening labour market risk and with it, demand for compensation.

¹⁵³ Vicenc Oller, Minister for Industry and Energy of the *Generalitat* (regional government) of Catalonia. *El Pais*, “Oller demands that the Generalitat participate in the industrial reconversion”, August 9, 1983.

¹⁵⁴ As emphasized by a top policymaker in charge of textiles reconversion in the Ministry of Industry, “When the average age is high, early retirement is much easier. If the state is willing to facilitate early retirement, have workers go into unemployment for 2 years, have the firm take care of one year and then the state takes care of unemployment [benefits] after that, you can retire people five years earlier. The core of worker demands revolved around this – that people leave in good conditions.” Author’s interview, April 3, 2012.

¹⁵⁵ *El Pais*, “Demands for the Baix Llobregat to be declared an Area of Urgent Reconversion”, June 18, 1984.

¹⁵⁶ *El Pais*, “Happy birthday for reconversion in textiles”, December 4, 1983. *El Pais*, “Textiles reconversion, a profitable sacrifice”, April 12, 1984.

5.3.2 Argentina: Cordoba, Mendoza and Buenos Aires

5.3.2.1 Uncompetitive regions: why was demand for compensation in Cordoba greater than in Mendoza?

The provinces of Cordoba and Mendoza were among the regions most exposed to the adverse effects of trade liberalisation. Both were among the country's most industrialised regions, and both were relatively uncompetitive. The province of Mendoza featured over 60% of production in unproductive sectors, while such levels reached over 70% in Cordoba. Like Asturias in Spain, however, Cordoba was heavily specialised. Cordoba's industry was made up of transport (30%), food (30%), machinery and equipment (8%), non-metallic minerals (5%), metal products (3%), electrical equipment (3%), paper (2%), leather (2%), rubber (2%), textiles (1%) and wood (1%).¹⁵⁷. Thus, 38% of the region's production in manufacturing was accounted for by the automobile and autoparts sector, with another 30% accounted for by the food industry – which was also facing difficulties due to currency appreciation. Together, they accounted for over 65% of employment in manufacturing. Of these, the automobile and associated autoparts sector made up the bulk of manufacturing. Cordoba was (and still is) home to much of the automobile sector in the country since the 1950s. The settling in 1952 of Aeronautic and Mechanical Industries of the State (IAME) fostered the development of a specialized labour market that laid the foundations for industrial growth (Cecchetto 1988). Fostered by the developmental policies of the Frondizi government, the entry in the late 1960s of transnational corporations into the auto sector contributed to the

¹⁵⁷ Data are for 1984 and are computed from the Argentine National Economic Census (INDEC, National Statistics Bureau). The numbers do not add to 100% because other very small shares of employment are accounted for by sectors such as leather or rubber, and/or because they do not include manufacturing “not elsewhere classified”.

expansion of the industry. Prominent firms located production in the region.¹⁵⁸ After a period of expansion in the 1960s and early 1970s, economic liberalization under the military dictatorship severely affected production in the industry, which suffered a drop throughout the 1980s that was not offset by the closing of trade barriers under President Alfonsín (Kosacoff, Todesca and Vispo 1991, Barbero and Motta 2007: 210). It also resulted in significant changes in the structure of industry. By 1990, the auto sector was composed of a combination of foreign and locally owned companies in the terminal industry (and to a lesser extent in auto parts).¹⁵⁹

Restructuring at first led to increases in productivity for the automobile sector. The Motor Vehicle Regime of December 1991, signed by peak associations and labour unions, involved a number of protectionist measures. They included a wage agreement between firms and unions and a reduction of the prices of vehicles, a tariff barrier of 30% and import quotas at a rate of 10% of the local production per year (Etchemendy 2001). In the context of the consumption boom triggered by stabilization and the overvalued currency, the industry increased production by almost 50% during the period 1991-1994 (Etchemendy 2011). However, partly as a result of the tequila crisis that hit Mexico in 1994, increased levels of activity were met with decreasing levels of employment. This, in turn, severely affected the auto parts sector, which was dependent

¹⁵⁸ According to one study of the auto industry in the region, the expansion of the auto sector stemming from the localization of FIAT and Ika-Renault, born of a merger between Renault and the local *Industrias Kaiser Argentina* (also a merger between foreign companies and IAME), and associated autoparts sector “constituted the material base for the transformation of the social and urban structure of the city [of Córdoba], which went from a mostly administrative and academic activity with strong middle class roots and gradual growth to an explosive process, with substantial immigration from other parts of the province and other provinces in the country” (Cecchetto 1988: 1).

¹⁵⁹ In 1990, eight companies produced transport vehicles in Argentina: Autolatina, Mercedes Benz, Scania and Renault-Ciadea were foreign, while Sevel, Iveco, A & L Decaroli and El Detalle were locally owned. Locally owned companies held brand licenses from foreign companies that had departed in the 80s, but would later come back. For instance, Sevel was the largest local producer and held licenses for FIAT and Peugeot, and was owned by the local conglomerate SOCMA. In turn, Renault would sell its majority participation to the local group in 1992, known as Ciadea. Autolatina was a merger of Ford and Volkswagen in 1986. Autolatina focused production in General Pacheco (Córdoba plant), with some production in Santa Fe (Villa Constitución plant). Sevel split production between Córdoba (Ferreira plant) and Buenos Aires province (Villa Bosch plant) and Renault settled in Córdoba (Santa Isabel plant).

on the terminals sector for its performance. Things were made worse by the fact that auto parts were not included in the special regime until 1996. As a result, from 1991 to 1995 the sector suffered persistent declines in production. Restructuring in the local auto parts industry during the period triggered the selling of capital to larger national and foreign auto parts companies, or the creation of joint ventures in which local auto parts firms retained ownership but received guidelines in terms of production from a transnational company (Yoguel 1998). This severely compromised small and medium enterprises, and contributed to regional downturn. Interviews with a former member of the small and medium firms' association in Cordoba emphasised the problems faced by the local auto parts industry in a region heavily reliant on the production of autos:

“[What was] the problem with the foreign auto parts industry? They substitute for imported products, but... then they export the profits, and then we have a problem with the trade balance and the current account. At first, you accept it, but at the very least, you want the government to incentivize national industry to make it competitive. The paradox was that we [local auto parts sector] were told to restructure, and when we did, ...we found ourselves in a dead end, because there was no internal demand and we could not [face the costs]. Restructuring was not meant to increase exports, it was at least to sell to the terminals.”¹⁶⁰

Moreover, currency appreciation hurt exports in the agro-industry, which made up a substantial portion of regional employment. This further depressed internal demand and contributed to regional downturn.

Cordoba's specialization on unproductive sectors had stark implications for workers' chances of reemployment. Regional downturn put pressure on employment levels, especially among the SME in the local auto parts sector, which “could not dismiss [its] workers, because it knew that they would not find work.”¹⁶¹ Liberalisation and associated restructuring mobilised opposition in the region. In the largest episode of the

¹⁶⁰ Author's interview in Cordoba, November 11, 2013.

¹⁶¹ Author's interview in Cordoba, November 11, 2013.

decade, more than 10000 *mediterraneos* (so called in reference to the region's landlocked location) rallied in a general strike in support of creating public employment.¹⁶² Later mobilisation in June and August 1995 saw large general strikes against unemployment and in favour of employment creation.¹⁶³ Cordoba was described as being among the regions with "very high levels of social conflict" in 1995, together with Santa Fe.¹⁶⁴ This is consistent with the high levels of support for compensation illustrated in Table 5.1. Over 60% of individuals surveyed in Cordoba stated their preference for greater state support of national industry instead of increasing economic openness.

Like those in Cordoba, workers employed in manufacturing in Mendoza faced potential income losses as a result of trade liberalisation. Together with Cordoba and Buenos Aires, Mendoza was among the more industrialised regions in the country, and had a strong tradition in the production of wine, which had benefitted from the introduction of technology by foreign capital in the 1950s and the temperate climate of the western Cuyo region. Overall, however, *Mendocino* industry was not competitive. Important sectors in manufacturing, such as home appliances and metal products, were relatively unproductive. In contrast to its neighbouring regions, Mendoza had not benefitted from the Industrial Promotion Regime set in place in the 1970s. The approval of Law 22702 in 1982 extended the special benefits of the industrial promotion regime, initially applicable to La Rioja and Tierra del Fuego, to San Luis, Catamarca and San Juan, but not to Mendoza (Sawers and Massacane 2001, Schwartz 1987).

¹⁶² *Pagina 12*, "Striking against the model. 10000 demonstrators in Cordoba", June 11, 1994.

¹⁶³ *Clarín*, "Cordoba, el jueves, paro general: protesta contra el ajuste y la desocupación", August 8, 1995. *Clarín*, "Fuerte adhesión al paro en Cordoba. Fue casi total en la industria, el comercio y el transporte", August 11, 1995.

¹⁶⁴ *Clarín*, "Warnings of conflict in 9 provinces", August 6, 1995.

The lifting of protection for intermediate goods such as rubber or paper, basic metals and chemicals had negative consequences for small and medium sized companies in the region, and was reflected in a number of closures. Liberalization in the context of currency appreciation led to difficulties among the region's smaller agro businesses. The currency peg affected the competitiveness of small producers, who "went bankrupt because... they could not compete with any price, not from China [nor] Brasil, let alone Europe or the USA".¹⁶⁵ The *precio ficticio* (the "fake price" peso-dollar, or currency peg) also led to the take-over of smaller producers by foreign-owned companies at very low prices, driving small producers out of business.

Compared to Cordoba, however, workers affected by liberalisation in the Mendocino industry faced greater outside options. The absence of industrial promotion led to a focus on agro-industries at the expense of consumer durables, thereby limiting industrial agglomeration and associated specialisation. As a result, the region enjoyed a relatively diversified industrial base and a dynamic fabric of small and medium sized firms (Gatto and Cetrangolo 2003). While almost 30% of regional employment in industry was in the food sector, the remaining employment was distributed between electrical equipment and home appliances (7%), chemicals (5%), non-metallic mineral products (4%), metal products (2%), basic metals (2%), wood (2%), textiles (2%) and paper (2%). Although the combination of liberalisation and currency appreciation led to many layoffs, an important part of the local workforce "could insert itself in the industrial fabric".¹⁶⁶ This happened despite the region's relative reliance on agricultural and food industries. As emphasised by a local expert,

"[In the province of San Luis] the impact of liberalization ... was not very important, because they needed the same amount of people in order to farm and harvest. In the case of Mendoza, you need more labour, because the crops and harvest are labour intensive

¹⁶⁵ Author's interview, City of Mendoza, December 6, 2012.

¹⁶⁶ Author's interview, City of Mendoza, December 6, 2012.

and it is somewhat of a craftwork. That led to many layoffs, because labour [in the agro-industry] is not skilled, as is characteristic of the agro industry where workers can do pretty much all tasks... Of course, what Mendoza does have... is a very powerful and diversified industry. And in spite of that crisis, [the region] reactivated itself”¹⁶⁷

Factors such as the very low skill level of the workforce in sectors affected by liberalisation made re-employment difficult. Interviewees emphasised that in the agro-business, this largely concerned a female population who had trouble inserting itself into the local productive fabric. Nonetheless, the net effect of liberalisation on the labour market was relatively contained. Although “[those that lost their jobs in the agro sector] became part of the mass of unemployed in the region, Mendoza did not have such high levels of unemployment as other industrialised regions in the country”¹⁶⁸ In important ways, this was due to the region’s diversified industry, which helped to contain levels of unemployment (Lindenboim and Gonzalez 2002) – at least until the 2000s, when levels of unemployment experienced sharp increases. Consistent with the argument, this translated into relatively low levels of support for compensatory measures. While 34% of those surveyed supported national industry, 65% supported free trade (65%).

5.3.2.2 Competitive regions: why was demand for compensation low in Buenos Aires?

Workers in Buenos Aires had few reasons to demand compensation at the onset of liberalisation. Compared to other Argentine regions, Buenos Aires was a competitive region with a strong fabric of small and medium sized firms. The province had traditionally concentrated much of Argentina’s industry. In addition to the exporting of agricultural products, the petro-chemicals and basic metals sector were among the more productive sectors in the region. Although highly protected, such sectors were also internationally competitive, with export shares far above other sectors in the region (Kosacoff 2010, Etchemendy 2011). However, a number of more traditional sectors in

¹⁶⁷ Author’s interview, City of Mendoza, December 6, 2012.

¹⁶⁸ Author’s interview, City of Mendoza, December 6, 2012.

the region faced restructuring. In contrast to the more productive private firms, public companies in oil and integrated steel faced severe international competition (Etchemendy 2011). Among them were the state steel mill SOMISA and the La Plata and General Mosconi refineries, both located in Buenos Aires. Although integrated steel sector was on average relatively productive, SOMISA had been hard hit by liberalisation in intermediate inputs. Restructuring of SOMISA involved significant capacity cuts and workforce reductions. The company employed around 12500 workers in 1990. When in May 1991 former labour minister Jorge Triaca was appointed auditor of the company by the Menem government, SOMISA faced a reduction of 40% of the labour force. Restructuring also involved the closure of one of the two blast furnaces and significant production cuts. In addition to the direct effects of restructuring, subsequent privatization led to the closure of many firms and suppliers whose economic livelihood was dependent on SOMISA.¹⁶⁹

Yet workers affected by restructuring in Buenos Aires province faced outside options. Industry in Buenos Aires was also significantly diversified, and harboured many different activities (Fritzsche and Vio 2000). In 1984, regional employment was shared between food (15%), oil (17%), transport (9%), chemicals (9%), textiles (8%), metal products (7%), rubber (7%), basic metals (5%), wood (5%), electrical equipment (5%), paper (3%), non-metallic minerals (3%), leather (2%) and machinery and equipment (1%). When SOMISA was sold to Siderar, owned by the powerful private holding Techint, excess workers were reallocated across manufacturing sectors in the region. This was arguably facilitated by the metals union, whose members “agreed that holidays would be taken throughout the year, so one worker not needed (in SOMISA) would cover another elsewhere. In the morning, you could be welding in plastics, and the day

¹⁶⁹ *La Nacion*, “Cafiero wants to attenuate social impact”, October 1991.

after you could work as an operator adjusting hot/cold rolled coils”.¹⁷⁰ Nonetheless, the existence of employment opportunities in the province made it possible for those affected by restructuring to find reemployment. This likely contributed to dampening demands for compensation. Interviews with former SOMISA workers revealed that the presence of outside options within the region enabled reemployment across sectors. In the words of one of them:

“We [SOMISA] consumed per day the [amount of] gas consumed by the city of Cordoba, which is the second city of the country. These are monster-factories. Thus, the social cost was very high... We also saw that in Spain, with the reconversion, [the factory at] Sagunto [in Valencia] was closed, and people ended up being either *gastronomico* or a secretary in management, or learned something else, and people were socially reabsorbed, in the social network. Our experience was similar, though Spain’s was better.”¹⁷¹

Restructuring nonetheless triggered opposition. The areas of Ramallo and San Nicolas, where SOMISA was located, were hard hit. According to a survey carried out between 1991 and 1993 in San Nicolas, 80% of workers had lost their jobs as a result of restructuring – and the bulk of the unemployed were the young and the over 45 (Beccaria and Quintar 1995: 406). Workers demanded that it be met with re-industrialising policies to offset the loss of income in an area that was heavily dependent on the firm.¹⁷² But as shown in Table 5.1 above, a majority of those surveyed in Buenos Aires province in 1993 – thus shortly after the salient episode of restructuring – supported free trade (53%) versus public support of national industry (46%) – of which SOMISA was a prime example.

¹⁷⁰ Author’s interview, Buenos Aires, November 20, 2012.

¹⁷¹ Author’s interview, Buenos Aires, November 20, 2012.

¹⁷² *Pagina 12*, “Alquimia financiera y empleos para bajar el coste social”, October 1991.

5.4 Conclusions

This chapter has addressed the individual implications stemming from Chapter 2 in selected regions in Spain and Argentina. Together, the quantitative and qualitative analyses emphasise that regional specialisation and competitiveness jointly shaped levels of demand in the two countries. The analyses of survey data provide evidence for the claim that individuals in specialized and uncompetitive regions support greater levels of compensation than similar individuals in diversified regions. They also suggest that individuals in competitive and specialized regions support relatively lower compensation than similar individuals in diversified regions.

The qualitative comparison complements these insights and shows that such regional features were important in shaping patterns of demand for compensation. Workers in Asturias and Cordoba, both highly specialised and uncompetitive, demanded very high levels of compensation. In contrast, those in more diversified regions such as the Basque Country and Mendoza, while equally uncompetitive, demanded comparatively lower levels of policy. Lastly, in the relatively competitive and diversified regions of Catalonia and Buenos Aires, trade losers demanded relatively low compensation. Also consistent with expectations, the case of Andalusia in Spain shows that trade losers in a competitive and specialised region nonetheless faced some risk, and this was reflected in relatively high levels of demand.

Altogether, the above findings provide support for the argument advanced in Chapter 2. Given this structure of preferences, Chapter 6 next evaluates the extent to which electoral and legislative institutions aggregated demand to shape patterns of policy.

5.5 Data and methodological appendices

Data appendix

Table A5.1. Regional employment shares across sectors in Argentina used to compute Herfindahl-Hirschmann Index (1984)

Region	Food/Tobacco	Textiles	Leather	Wood/Cork	Paper/Edit	Coke	Chemicals
Capital Federal	0.16	0.15	0.032	0.015	0.108	0.007	0.14
Buenos Aires	0.149	0.076	0.024	0.052	0.037	0.192	0.094
Catamarca	0.153	0.199	0	0.01	0.002	0	0
Chaco	0.118	0.487	0.001	0.071	0.003	0	0.178
Chubut	0.092	0.434	0	0.009	0.005	0	0.003
Cordoba	0.298	0.013	0.023	0.013	0.029	0.001	0.034
Corrientes	0.339	0.026	0.012	0.02	0.007	0	0
Entre Rios	0.752	0.004	0.007	0.026	0.033	0	0.007
Formosa	0.184	0.285	0.017	0.189	0.027	0	0
Jujuy	0.546	0.001	0.001	0.003	0.006	0	0
La Pampa	0.455	0.002	0.001	0.017	0.007	0	0.001
La Rioja	0.135	0.386	0	0.007	0.061	0	0.014
Mendoza	0.291	0.012	0.001	0.019	0.013	0.001	0.043
Misiones	0.426	0.006	0.008	0.151	0.002	0	0
Neuquen	0.049	0.001	0.001	0.02	0.003	0	0
Rio Negro	0.509	0.001	0.001	0.058	0.04	0	0.195
Salta	0.141	0.006	0.006	0.034	0.004	0	0.035
San Juan	0.536	0.005	0.006	0.02	0.003	0	0.153
San Luis	0.126	0.343	0.043	0.005	0.017	0	0.005
Santa Cruz	0.733	0	0	0.035	0.007	0	0
Santa Fe	0.331	0.047	0.024	0.022	0.029	0.001	0.11
Santiago Estero	0.279	0.129	0.012	0.079	0.003	0	0
Tierra Fuego	0.007	0.161	0	0.015	0.001	0	0
Tucuman	0.661	0.092	0.024	0.007	0.01	0	0.002

Region	Rubber	Non metallic minerals	Basic metals	Metal forging	Machinery	Electrical	Transpo rt	Manuf. nec
Capital Federal	0.044	0.008	0.031	0.069	0.011	0.077	0.041	0.009
Buenos Aires	0.065	0.034	0.058	0.067	0.014	0.048	0.1	0.002
Catamarca	0.008	0.009	0	0.027	0	0.006	0.002	0.001
Chaco	0.005	0.032	0	0.016	0.003	0.004	0.015	0.001
Chubut	0.063	0.014	0.266	0.015	0.047	0.001	0.003	0.001
Cordoba	0.026	0.052	0.013	0.039	0.09	0.038	0.303	0.002
Corrientes	0.001	0.009	0	0.007	0.001	0.001	0.003	0.001
Entre Rios	0.025	0.008	0	0.018	0.008	0.004	0.007	0.001
Formosa	0.002	0.047	0	0.028	0	0.003	0.007	0.001
Jujuy	0	0.006	0.192	0.004	0.01	0.001	0.003	0.001
La Pampa	0.004	0.001	0	0.005	0.004	0.008	0.022	0.001
La Rioja	0.065	0.072	0	0.011	0.001	0.001	0.001	0
Mendoza	0.005	0.035	0.023	0.016	0.003	0.073	0.005	0.001
Misiones	0.027	0.009	0	0.012	0.007	0.002	0.006	0.001
Neuquen	0	0.178	0	0.022	0.004	0.001	0.007	0.001
Rio Negro	0.003	0.039	0	0.02	0.028	0.003	0.015	0
Salta	0.004	0.007	0	0.009	0.01	0.004	0.006	0.001
San Juan	0.014	0.158	0	0.011	0.006	0.005	0.008	0.001
San Luis	0.092	0.032	0	0.043	0.004	0.007	0.002	0.003
Santa Cruz	0	0.01	0	0.024	0	0.007	0.004	0
Santa Fe	0.048	0.017	0.082	0.054	0.054	0.035	0.069	0.001
Santiago Estero	0.014	0.044	0	0.018	0.002	0.004	0.007	0.002
Tierra Fuego	0.047	0.001	0	0.003	0	0.708	0	0
Tucuman	0.01	0.01	0	0.014	0.007	0.012	0.02	0.001

Table A5.2. Regional employment shares across sectors in Spain used to compute Herfindahl-Hirschmann Index (1981-1983)

Region	Energy	Metal Min.	Basic metals	Nonmetal Min.	Chemicals	Metal products	Machinery
Andalucia	0.048	0.015	0.023	0.023	0.038	0.068	0.026
Aragon	0.073	0.002	0.022	0.008	0.049	0.137	0.137
Asturias	0.319	0.001	0.256	0.013	0.013	0.088	0.018
Baleares	0.066	0	0.001	0.017	0.009	0.074	0.007
Canarias	0.118	0	0.001	0.012	0.024	0.049	0.013
Cantabria	0.028	0.027	0.121	0.012	0.088	0.18	0.027
Castilla Leon	0.116	0.003	0.011	0.015	0.037	0.079	0.033
Castilla La Mancha	0.05	0.013	0.003	0.016	0.05	0.086	0.021
Catalunya	0.033	0.001	0.009	0.007	0.096	0.114	0.071
Valencia	0.014	0	0.024	0.008	0.024	0.079	0.036
Extremadura	0.055	0.006	0.013	0.01	0.011	0.088	0.056
Galicia	0.064	0.009	0.035	0.026	0.019	0.087	0.021
Madrid	0.021	0	0.012	0.005	0.09	0.105	0.077
Murcia	0.041	0.015	0.015	0.012	0.05	0.077	0.032
Navarra	0.012	0	0.073	0.047	0.024	0.133	0.048
Pais Vasco	0.021	0.007	0.141	0.004	0.033	0.235	0.107
Rioja	0.013	0	0.004	0.007	0.015	0.1	0.048

Region	Electrical	Transport	Food	Textiles	Leather	Wood	Paper	Rubber
Andalucia	0.031	0.107	0.296	0.096	0.012	0.061	0.033	0.011
Aragon	0.061	0.059	0.121	0.093	0.048	0.067	0.033	0.031
Asturias	0.012	0.046	0.084	0.024	0.003	0.041	0.015	0.004
Baleares	0.009	0.009	0.182	0.037	0.25	0.149	0.038	0.014
Canarias	0.012	0.021	0.42	0.015	0.003	0.097	0.067	0.018
Cantabria	0.101	0.057	0.166	0.02	0.006	0.04	0.021	0.054
Castilla Leon	0.016	0.155	0.201	0.065	0.01	0.084	0.033	0.052
Castilla La Mancha	0.046	0.018	0.241	0.12	0.071	0.101	0.02	0.017
Catalunya	0.075	0.084	0.104	0.222	0.012	0.055	0.055	0.045
Valencia	0.01	0.051	0.123	0.143	0.122	0.144	0.033	0.045
Extremadura	0.004	0.004	0.372	0.115	0.007	0.129	0.015	0.012
Galicia	0.025	0.209	0.194	0.059	0.009	0.11	0.024	0.015
Madrid	0.15	0.124	0.099	0.067	0.013	0.048	0.048	0.029
Murcia	0.006	0.085	0.306	0.064	0.021	0.149	0.03	0.028
Navarra	0.076	0.111	0.186	0.039	0.01	0.063	0.078	0.039
Pais Vasco	0.081	0.087	0.056	0.019	0.003	0.048	0.053	0.072
Rioja	0.021	0.019	0.262	0.137	0.117	0.109	0.046	0.058

Methodological Appendix: Research design for interviews

I conducted 18 semi-structured interviews in Spain and 25 in Argentina. Semi-structured interviews are commonly used to interview elites or experts, and offer a combination of flexibility and structure. Interviewees in Spain and Argentina were given the possibility to reflect freely on some aspect, and asked about particular questions in others.

Interviewees were a combination of policymakers involved in the process of trade liberalisation and industrial restructuring, union members (all of whom were employed in sectors under reconversion at the time), directors of companies subjected to restructuring, and experts. Policymakers included top-level political figures such as Ministers and civil servants in charge of managing policy. All were Spanish or Argentinian.

In each country, I established a pool of eligible interviewees by approaching experts and academics of market reform and social policy in the two countries, and asking for names of potential interviewees from the pool of policymakers, union members and employers.

Interviews had the following structure. I briefly described the purpose of the project and the theoretical background. Respondents were asked about five sets of questions: their role in the process of industrial restructuring, the context of restructuring, mechanisms of compensation, preferences of workers, employers and policymakers, and finally, about the political process underpinning compensation. In the first set of questions, interviewees were asked to describe their role in the process of industrial restructuring (what position they had and where), and to freely reflect on the role of their organisation in the process of restructuring. The second set of questions asked interviewees to describe the reconversion process, the factors that gave rise to it, the extent to which it was a response to exogenous factors, and how it was combined with other policy

instruments (such as regulation). The third set of questions turned on compensation instruments, and asked respondents to describe what policy instruments were made available, what factors restricted the choice of policies, what compensation instruments had more discretion by regional governments, and what demands were made from winning sectors. The fourth set of questions asked interviewees what workers employed in sectors under restructuring demanded and why, what employers demanded and why, whether differences in demand existed between sectors that were concentrated in particular regions, and whether disagreements existed between regional and national policymakers on the mechanisms for compensation. Finally, in a fifth set of questions interviewees were asked who decided what compensation mechanisms to provide and on what basis, what regions the government privileged, what veto mechanisms existed on the part of regional interests, and what regions had more weight in the political party in government.

Interviewees were asked for permission to mention their name and affiliation. The Appendix lists the names and affiliation of those who consented to it. The names are listed by alphabetical order for each country.

List of Interviewees

Spain

Joaquin Almunia, Minister of Employment and Social Security (1982-1986), Madrid, April 4, 2012.

Nestor Alvarez, Representative of Comisiones Obreras (union linked to the Communist Party) in the Employment Promotion Fund and member of the Works Council of Altos Hornos de Vizcaya, Bilbao, February 29, 2012.

Former Senior Official, Ministry of Industry and Energy (1988-1993), Madrid, March 7, 2012.

Senior Official in charge of the *Gerencia* for the Metal sector (1986-1990), Ministry of Industry and Energy. Madrid, March 6, 2012.

Senior official, Ministry of Industry and Energy (1986-1988), Madrid, March 6, 2012.

Rafael Fernandez Canas, UGT, Communications Official for Metal and Construction. Madrid, February 27, 2012.

Former CEO, *Altos Hornos de Vizcaya*. Bilbao, March 1, 2012.

Former Secretary-General of the Metal Federation of the UGT (Union General Trabajadores), March 2012.

Alvaro Espina, Secretary of Employment, Ministry of Employment and Social Security (1985-1991), Madrid, March 9, 2012.

Oscar Fanjul, Ministry of Industry and Energy, Senior Official (1984-1986), Madrid, April 18, 2012.

Miguel Angel Feito Hernandez, Senior Official, Ministry of Industry and Energy, DG Chemical Industries, Construction and Pharmaceuticals (1982-1986), Madrid, April 3, 2012.

Senior Official, Former representative of the government in the Basque Country, Madrid, March 2012.

Eduardo Lafuentes Gonzalez, Secretary-General UGT Asturias (1975-1990), former worker at the shipyard Duro Felguera. Madrid, March 8, 2012.

Senior Official, Ministry of Industry and Energy (1984-1986), Madrid, April 19, 2012.

Senior Official, DG Relations with the European Community (1982-1985), Madrid, March 7, 2012.

Pedro Rodriguez, former worker at La Naval (Sestao, Basque Country). Bilbao, February 29, 2012.

Jose Ignacio San Miguel Llanedo, UGT member, former worker at Aceros Corrugados, Madrid, March 8, 2012.

Senior Official, Minister of Industry and Energy (1982-1985), Minister of Economy (1986-1993). Madrid, March 2, 2012.

Argentina

Jorge Asso, Labour Market Specialist, Universidad Nacional de Cuyo, Mendoza, December 5, 2010.

Armando Caro Figueroa, Minister of Employment and Social Affairs (1994-1997), Salta, November 22, 2012.

Oscar Cetrangolo, Former Official, Ministry of Economy and Finance, DG Relations with the Provinces, Buenos Aires, November 15, 2012.

Rodolfo Diaz, Minister of Employment and Social Affairs (1991-1992), Buenos Aires, October 25, 2012.

Carlos Corach, Minister of Home Affairs (1995-1999), October 9, 2012.

Domingo Cavallo, Minister of Economy and Finance (1991-1996), Buenos Aires, October 22, 2012.

Naldo Brunelli, Union Obrera Metalurgica (Metal Union), Section Leader San Nicolas, Buenos Aires, November 20, 2012.

Laura Golbert, Senior Researcher, CEDES (Centro de Estudios de Estado y Sociedad), Buenos Aires, October 30, 2012.

Former Senior Official, Ministry of Economy in charge of MERCOSUR negotiations, Buenos Aires, October 10, 2012.

Ricardo Lopez Murphy, Former Minister of Economy (2001) and Chief Economist at FIEL (Fundacion de Investigaciones Economicas Latinoamericanas), Buenos Aires, October 2012.

Former Senior official, Ministry of Social Development, Department of Social Policies and Human Development (2003-2007). Buenos Aires, November 12, 2012.

Damian Bonari, Former Official, Ministry of Economy and Finance, DG Analysis of Public Spending and Social Policies. Buenos Aires, November 14, 2012.

Former Senior Official, Ministry of Economy and Finance, DG Relations with the Provinces (1999-2000), Buenos Aires, November 15, 2012.

Ruben Lo Vuolo, Academic Director and Senior Researcher, Centro Interdisciplinario para el Estudio de Políticas Publicas (CIEPP), Buenos Aires, November 14, 2012.

Enrique Mantilla, President of CERA (Chamber of Exports of the Argentine Republic),

Buenos Aires, November 29, 2012.

Former Senior Manager of steel holding company TECHINT. Buenos Aires, November 28, 2012.

Former Senior Official, Minister of Economy and Finance (1999-2001), Buenos Aires, November 30, 2012.

Julio Nogues, Member of the Argentine National Academy of Economic Sciences and author of *Agro e Industria: del centenario al bicentenario* (Ciudad Argentina, 2011), Buenos Aires, November 23, 2012.

Former Senior Official, Coordinator of the Monitoring and Evaluation of Social Policies System (SIEMPRO), (1994-2002). October 29, 2012.

Senior Official, SMATA (Autos union), Cordoba (1992-1996).

Marta Novick, Senior Official, Ministry of Employment and Social Affairs, Department of Employment Studies, Buenos Aires, November 14, 2012.

Emilia Eugenia Roca, Ministry of Employment and Social Security, DG Social Security, Buenos Aires, December 20, 2012.

Fabian Repetto, Director, Social Protection Programme, CIPPEC (Centro de Implementación de Políticas Públicas para la Equidad y el Crecimiento), Buenos Aires, November 5, 2012

Former President of APYME-Cordoba (Association of Small and Medium Sized Enterprises), Cordoba City, November 20, 2012.

Bernardo Kosacoff, Senior Policy Expert, CEPAL, Buenos Aires, November 2012.

Geographical concentration, institutions and compensation:

A case-study analysis of Spain and Argentina

Chapter 5 looked at how the geographical concentration of losing interests shaped demand for compensation in Spanish and Argentine regions. It showed that trade losers in specialized and uncompetitive regions faced higher risks and demanded more compensation than those in diversified regions. Chapter 4 provided evidence of the complex relationship between regional economic conditions, political institutions and compensation in open economies. Consistent with the model outlined in Chapter 2, the findings suggest that relative to those elected under proportional rules, policymakers elected in systems with low district magnitude provide greater levels of compensation and thus cater to the demands of trade losers to a greater extent when the latter are geographically concentrated. They also suggest that in the presence of a strong upper chamber, the effect of electoral rules on compensation is dampened. Given data constraints, however, the broad cross-national statistical analyses in Chapter 4 provide a limited basis to test some of the implications outlined in the theoretical chapter. In particular, testing the effect of electoral rules in the presence of a strong upper chamber requires data on the preferences of regional legislators that is not available cross-nationally.

To get more substantively at the mechanisms underpinning some of the implications of the argument, the chapter conducts an in-depth examination of the politics of compensation in Spain and Argentina. Fleshing out the interplay of regional demand and institutions in the provision of compensation is important, because existing research has

arguably not identified the mechanisms by which different institutional configurations might lead to greater or lesser compensation under trade. Scholars commonly suggest that proportional institutions systematically produce greater levels of social spending. To the extent that policies that compensate for income loss are an important part of social spending, the findings in Chapter 4 qualify the widespread argument that proportional rules systematically lead to greater social spending (Rickard 2012b, Barber 2014). With some exceptions, extant arguments appear to have insufficiently emphasised the narrow conditions under which majoritarian institutions may provide greater compensation, and failed to appreciate those under which proportional government may be less responsive to those most at risk. This chapter contributes to existing research in two ways. Firstly, it explores the role of contextual factors (economic and institutional) in the relationship between electoral rules and the provision of compensation. Consistent with the argument, it thus emphasises a context-specific effect of electoral rules on the provision of compensation. Secondly, it disentangles some of the factors claimed in existing research to drive compensation by providing an in-depth qualitative study of the politics of compensation in two relevant countries for comparison.

The aim of this chapter is thus to clarify the relationship between regional demands, institutions and compensation. In particular, it focuses on the role of upper chambers (or lack thereof) in shaping the effect of electoral rules on the provision of compensation. The lack of data on the preferences of representatives in the upper (and lower) house makes it necessary to trace causal mechanisms via case study. Spain and Argentina are good cases for this task. Both countries underwent far-reaching processes of liberalization, exhibit significant regional differences, share proportional rules for the lower chamber and differ in the extent of regional representation. By exploring policy processes in both countries, the chapter sheds light on the mechanisms driving policy

outcomes. It distinguishes between the preferences of regional interests with and without representation in the national policymaking process, and clarifies the ways in which the presence (or absence) of regional veto players shaped policy outcomes.

The analysis also clarifies the role of electoral rules in the provision of compensation. In the absence of a strong upper chamber, the case of Spain sheds light on the interplay between regional demands and political incentives under PR. In addition, the Argentine case study also makes it possible to explore how electoral incentives drive policy patterns in the absence of regional dynamics. Exploring the distribution of programmes that are not subject to congressional oversight illustrates some of the above patterns.

Consistent with expectations in the theoretical chapter, this chapter shows that levels of compensation in Spain were relatively low. In Spain, policymakers selected under proportional rules did not cater to concentrated losers from trade. Rather, they targeted groups of voters that lacked geographical concentration by increasing spending on pensions, education and health, at the expense of active and passive labour market policies. In Argentina, policymakers in the upper house with a preference for relatively low compensation succeeded in imposing their policy preferences, but regional representatives with preferences for high compensation were able to introduce modifications that served their purposes. Moreover, an analysis of employment programmes, over which the government enjoyed discretion, shows that in the absence of regional veto players, policymakers with incentives to target geographically concentrated interests targeted policy to specialised regions.

The chapter is structured as follows. A first section justifies the selection of Spain and Argentina in some detail. A second section focuses on the dynamics of compensation in Spain by first reviewing the economic and political context and then looking at the regional distribution of spending specific to reconversion. A third section focuses on the

Argentine case. It first provides the macroeconomic backdrop to adjustment and then delves into a study of legislative patterns in the provision of compensation.

6.1 The case for Spain and Argentina

Spain and Argentina represent significant variation on the two analytical dimensions underpinning the theoretical argument, and thus constitute excellent cases for comparison. Chapter 5 emphasized the variation in the distribution of losing interests in both countries over the period of study. Like Spain, Argentina was characterized by significant regional economic heterogeneity. While much of the country's industrial activity was clustered in a few regions, Argentina also exhibited strong differences *within* regions (with some industrial regions more dependent than others on losing interests). Such strong regional economic heterogeneity at the onset of liberalization makes both countries excellent case studies.

On the institutional dimension, both countries are governed by proportional rules for selection of lower house deputies but differ in the representation of regional interests. In Spain, deputies are elected by closed-list representation using the D'Hondt (PR) formula. The electoral system was deliberately designed to over-represent rural provinces (thought to benefit conservative forces) and ensure the emergence of a stable two-party political system at the national level (Montero 1998, Hopkin 2005). Although formally in place, the second chamber in Spain had (and still has) very limited influence in national policy-making. Common institutions to ensure "shared-rule" were arguably absent. The 1978 Constitution established the Senate as the chamber for territorial representation, but the existence of similar selection rules across chambers runs counter to the representation of regional interests. Senators from each province are elected on the basis of plurality rule, distinct from the proportional rules that govern election to the lower house. However, a

majority of Senate members are elected at the same time as those of the national parliament, as well as on the same territorial basis (the province).¹⁷³ This has prevented the upper house from acquiring a partisan profile different from that of the lower house. In fact, in most legislative elections since the start of democracy, the majorities in both houses have shown the same political orientation (Juberias 1999). Finally, in cases of disagreement, the lower house prevails.¹⁷⁴ As emphasized by Beramendi (2012), this severely limits the formal participation of regions in the production of national legislation.

It is important to note that the absence of a strong upper house has not, over time, prevented the representation of regional interests in the national policymaking process. This is related to two aspects. A first aspect concerns the electoral asymmetry characterizing the Spanish electoral system. Electoral asymmetry refers to the differences in the electoral success of political forces representing regional interests. The Spanish electoral system thus enables nationalist parties with strong support in their regions (such as the Basque Nationalist Party or the Nationalist Party of Catalonia) to have a growing presence in the national parliament. This differential in terms of social and political presence has conditioned the evolution of federalism in Spain from an early stage (Beramendi 2012). Secondly, ongoing processes of political and fiscal decentralization have over time increased the incentives of regional representatives in the national parliament to represent constituent interests (Leon 2007, Beramendi 2012). This has greatly increased the coalition potential of regional parties at the national level (Linz and Montero 1999). However, as the experience of the 1990s shows, the coalition potential of such regions only became relevant in the absence of a legislative majority by the

¹⁷³ In fact, each province is allocated four seats, totaling 208 of the 256 seats. The remaining seats are appointed by the different AC regional parliaments. Each AC must appoint one senator by default plus one more per million inhabitants within its boundaries (art. 69.5). They make up the balance of seats, between 44 and 48 depending on the year.

¹⁷⁴ Article 90.2 of the Spanish Constitution, 1978.

governing party.¹⁷⁵ In the presence of a second chamber with legislative powers, a legislative majority in the lower house can be reined in.¹⁷⁶

In contrast to Spain, Argentina constitutes a clear example of a bicameral system with a strong upper house, where regions can steer national policy towards their interests due to their political weight in the national policymaking process. This makes Argentina an excellent case for exploring the influence of regional economic differences in the presence of a strong upper house. The Argentine legislature consists of a lower house elected on the basis of population and an upper house with strong policymaking powers designed to represent territorial interests. The Chamber of Deputies is elected by closed-list proportional representation (also using the D'Hondt formula) and has 257 deputies. As in Spain, this allows for the representation of local minorities or local majority party factions at the national level. Until a 1994 reform, the Argentine Senate consisted of 48 members who were indirectly elected by each provincial legislature. These selection procedures were abrogated by a 1994 constitutional amendment, and direct elections took place in 2001.¹⁷⁷ Both houses are divided into committees. Bills are first sent to committees, which may report on them or not.¹⁷⁸ In addition, both overrepresent the smaller provinces (Calvo and Gibson 2000). According to existing studies, the Argentine Senate ranked highest on a scale of territorial overrepresentation among the world's upper chambers (Calvo and Gibson 2000: 35). Until 1995, largely underpopulated and rural regions accounted for 83% of total seats in the Senate (40 out of 48 seats) and held

¹⁷⁵ During 1993-1996, the central government governed as a minority government with the support of regional parties in the national legislature.

¹⁷⁶ In addition, much decentralization in the early 1980s was political, and involved the construction of regional political institutions as well as the transfer of some services. Fiscal decentralization, which has been argued to drive political incentives to pursue regional priorities at the national level, was limited and did not take off until the late 1980s. In short, there are reasons to believe that the centrifugal dynamics that marked the 1990s and 2000s in Spain were relatively contained at the start of reconversion (Beramendi 2011).

¹⁷⁷ The reform expanded the pool of senators from 48 to 72, three senators per province. The senate is elected by plurality, with the winning party taking two seats and the second party taking the third.

¹⁷⁸ A motion approved by a majority of the floor may request that some other committee report on the bill (Bonvecchi 2010: 24).

30% of the national population. This implied a massive representation gap between the most populated province and the least (Gibson and Calvo 2000).¹⁷⁹

Like many bicameral systems with strong upper houses, the Argentine legislative process is also characterized by rules that encourage the formation of large coalitions. The emergence of large legislative coalitions, in turn, induces policymakers to settle on the lowest common denominator to ensure passage of policy. Simply put, if a coalition of small and large provinces is necessary for a bill to pass through both houses of Congress, pivotal legislators in the lower house will have incentives to propose a level of policy that takes into account the preferences of the legislative veto. Two features of policymaking have a direct effect on the size of legislative coalitions (Bonvecchi 2010): the open amendment rule for bills and the majorities required to overturn decisions by the second chamber (as well as presidential vetoes). While the first is a feature of ordinary legislation, the second applies to fiscal policymaking. An open amendment rule implies that any committee or chamber may amend or reject any bill without restrictions.¹⁸⁰ Bills can be initiated by Congress or the Executive, and until a 1994 constitutional reform, could shuttle twice per house of Congress (and only once since then). In turn, if the second chamber amends a bill, “the majority required to overturn or change such amendments must match the majority employed to introduce it” (Bonvecchi 2010: 24).¹⁸¹

Additional rules governing particular areas of fiscal policymaking also foster the emergence of large legislative coalitions. For instance, the constitutionally mandated division of tax sources between regions and the federal government implies that the latter

¹⁷⁹ With a population of 12.6 million, Buenos Aires province is granted three senators, the same number received by Tierra del Fuego, with a population of 59,000. Thus, one vote in Tierra del Fuego is worth 214 votes in Buenos Aires. Similar gaps exist between Buenos Aires and most provinces of the interior. Only one of the 19 peripheral provinces has more than 10 percent of the population of Buenos Aires. With 40 percent of the population, Buenos Aires province holds 4 percent of the senate seats.

¹⁸⁰ With the exception of fiscal federalism (Bonvecchi 2010: 24).

¹⁸¹ In turn, if the president vetoes a bill and Congress insists on it, both houses must gather two-thirds of their members to overturn the veto.

cannot obtain any tax revenues without the cooperation of provincial representatives.¹⁸²

In addition, the Constitution enables the lower house to initiate tax legislation, conferring an advantage on the larger provinces with a greater number of deputies. However, smaller provinces overrepresented in the upper house might garner a majority to amend or overturn the decision of the lower house. This induces the creation of large coalitions comprising small and large and, as will be shown below, importing and exporting provinces. Finally, special majorities are needed to introduce or change earmarking of tax revenues, requiring 50 percent plus one of each house. As a result, legislators from large and small provinces have incentives to agree upon earmarking criteria.

Similar rules also govern law-making in revenue sharing and, to a lesser extent, budgetary policymaking. Dating back to the first revenue-sharing scheme introduced in 1934, revenue sharing legislation (whether this concern incorporating new taxes to the common revenue pool or the criteria for the distribution of shareable revenues) must be first agreed upon by the president and provincial governors, then presented to Congress for approval, and lastly, ratified by provincial legislatures (Wibbels 2005). This implies that decisions on the distribution of fiscal revenues cannot be unilaterally taken, but must garner the agreement of all parties. In sum, large legislative coalitions fostered by Argentina's bicameral system induce representatives to settle on the smallest common denominator to ensure passage of policy across both houses.

6.2 Compensation in Spain, 1980-1990

¹⁸² The Constitution stipulates that the provinces and the federal government must share direct and indirect taxes, other than customs duties; that proceeds from customs duties belong exclusively to the federal government, and that Congress may impose direct taxes only for specific periods of time, such that only indirect taxes may be in force for an indefinite time period (Bonvecchi 2010: 25).

Chapter 2 argues that in the absence of an institutionally strong second chamber, policymakers elected under proportional rules have few incentives to support the interests of geographically concentrated trade losers. This should lead to relatively low levels of compensation. In Spain, policymakers selected under proportional rules did not cater to concentrated losers from trade. Rather, they targeted groups of voters that lacked geographical concentration by increasing spending on pensions, education and health, at the expense of active and passive labour market policies.

Exploring the political determinants of compensation in Spain is important for a number of reasons. First, well-established arguments that would predict high levels of compensation posit different mechanisms. Standard arguments in comparative political economy suggest that the presence of social democratic government and proportional electoral rules should have led to greater levels of social spending (Huber and Stephens 2001, Huo et al. 2008, Persson and Tabellini 2003). To the extent that unemployment protection and active labour market policies constitute “broad” social programmes that do not discriminate geographically among beneficiaries, proportional rules could have been expected to induce policymakers to increase compensation. Consistent with arguments in political economy, the analysis of Spain shows that spending on broad transfers such as pensions and health increased (Persson and Tabellini 2000, 2003). Yet it also shows that spending on active labour market policies specifically addressing reemployment (vocational training and employment subsidies) and on passive labour market policies such as unemployment benefits decreased. Importantly, this occurred despite increases in overall spending on active policies. Thus, spending on public infrastructure increased significantly at the expense of reemployment policies, clearly signalling the low priority accorded by policymakers to the latter.

Second, arguments based on the presence of dualised labour markets overlook variation in levels of geographical concentration for outsiders. Prominent arguments attribute low levels of compensation under social democratic governments to the existence of dualised labour markets (Rueda 2005). In Spain, social democratic policymakers targeted politically mobilised labour market insiders at the expense of outsiders (Rueda 2007). To the extent that broad programmes were privileged that did not specifically target labour market risk, policy in Spain targeted labour market insiders. Under some assumptions, the argument that policymakers in Spain did not cater to concentrated trade losers is consistent with this view. Arguably, labour market insiders lack significant geographical concentration, while the unemployed may be more or less geographically concentrated (Overman and Puga 2010). The theoretical argument and empirical analysis suggest that *dispersed* outsiders may not differ that much from insiders in terms of policy preferences. Once this is taken into account, the picture that emerges from Spain is consistent with insider-outsider arguments.

To explore the extent to which political incentives shaped patterns of compensation in the absence of institutionalised regional representation, the next section provides the macroeconomic backdrop to economic reform, while the following section looks at the regional distribution of spending specific to reconversion.

6.2.1 Compensation in the wake of transition

To shed light on patterns of compensation in Spain, it is helpful to review macroeconomic developments in the wake of political transition. The death of Franco in November 1975 had left behind an economy in stagflation. Growth rates in the late 70s had fallen to 1.3% from the 8% in the late 60s, inflation was still under 20% in 1979, industrial production had fallen sharply as a result of the second oil crisis, the trade deficit had grown and the budget deficit had jumped to 5.6% by 1982, mostly financed

by the Bank of Spain's printing money (Maravall 1993: 89, Espina 1990: 52-53). The newly elected government of Adolfo Suarez (*Union de Centro Democratico*) believed that economic reforms would compromise democratic stability. In contrast, the Gonzalez government elected in October 1982 believed that a prolonged economic crisis increased the risk of political instability, and engaged in broad economic reforms to "catch up with Western Europe"¹⁸³. The goal was to secure the solvency of the state and increase economic competitiveness to attain economic stability and avoid policy U-turns that would endanger democracy. This involved a comprehensive adjustment programme, ranging from tax reform, deficit reduction and trade liberalisation to price deregulation and suppression of subsidies.

Yet political transition had also brought to the fore demands for social reform (Przeworski et al. 1990). The government faced immense pressures to expand social policies in a country where the provision of welfare was very limited. Demands for social welfare in Spain were particularly salient: according to a 1981 European values study of 13 countries, Spain ranked highest in "support for social policies" (McDonough et al. 1986). Meeting such demands required the extension and reorganisation of social policies in the areas of pensions, unemployment benefits, education and health. Thus, economic and social reforms did not necessarily go in the same direction, since greater social expenditure could reduce the solvency of the state.

From 1982-1986 the Spanish economy went through deep adjustment in order to "create the conditions for sustained growth, reduce the basic macroeconomic problems of the inflation rate, the public deficit and the external deficit, carrying out reconversion of the industrial sector, reforming capital markets, introducing changes in the labour markets and reorganizing social security" (Maravall 1993: 95). To do this, the government turned

¹⁸³ Author's interview, Madrid, July 10, 2014.

to a mix of demand and supply measures. Inflation was reduced through restrictive monetary policies and very high interest rates. In turn, the deficit was reduced from 5.6% of GDP in 1982 to 2.4% in 1990 thanks in part to the slowdown in the rate of growth of public expenditure (increased by 4.5 percentage points from 1982-1989 compared to the 10.5 percentage points from 1977-1982) (Maravall 1993: 95). Larger tax revenues financed public expenditure. Although reduced, growth in social expenditure, and in particular in pensions, health and education, aimed to maintain demand and avoid underconsumption. At the same time, the state aimed to stimulate investment (Boix 1998).

Reforms led to a serious increase in unemployment, which became “by far the greatest social and economic problem in the new democracy” (Maravall 1993: 108). The rate of unemployment went from 3.9% in 1975 to 16.2% in 1982 and 21.9% in 1985. The loss of jobs was partly the result of the Franco legacy (real wage growth above productivity, low investment in productive capital), partly the result of an increase in the active population fuelled by the expansion of the active female population (Espina 1990: 361-7). It was compounded by the loss of jobs as a result of industrial reconversion.

Although the reforms ultimately increased competitiveness and helped economic recovery, they affected unemployment rather than wages.¹⁸⁴

However, concern for unemployment and *reemployment* among policymakers was limited. In the view of some scholars, this was analogous to a trade-off between wages or transfers and social policies (Maravall 1993: 110). The government was less concerned about increased wages and transfer payments such as unemployment benefits than unions, and much more concerned about policies that would lead to the “collective good” (Maravall 1993: 110). In negotiations with trade unions, the government often adduced

¹⁸⁴ This contrasted with other instances of reform, such as Portugal or Greece, where reforms were at the cost of wages of employed workers and employment overall did not suffer much (Maravall 1993: 109)

that wage and transfer increases would “have to be paid for by reducing the budgets for more and better health, education and pensions” and presented wage moderation and limited transfer payments as “the counterpart of a larger social wage that would include social policies leading to the collective good” (Maravall 1993: 110). Such policies could be targeted to a broad segment of the electorate, as universal entitlement meant that payments (for instance, in pensions) were unrelated to personal contributions. Arguably, given the unequal distribution of unemployment across territories, increasing spending on unemployment benefits was politically less attractive to policymakers who were dependent for survival on the support of as broad a segment of the population as possible.

The priority given to broad social policies was apparent in new legislation on pensions, education and public health, as well as the composition of spending. Basic pensions were introduced to supplement voluntary and contributory pension schemes, with payments unrelated to contributions and financed by the general budget. The 1986 *Ley General de Sanidad* set up an integrated public system providing universal protection, the *Ley de Derecho a la Educacion* passed in 1985 democratised the educational system and in 1983 the Law of Reform of the University gave universities financial, academic and organisational autonomy. In turn, expenditure on pensions increased from 8.2% (of GDP) to 8.8% in 1988 and 10.5% in 1995. Health spending increased by 4 percentage points from 1982 to 1988 and by another 12 percentage points in 1995, and education increased from 3% in 1982 to 1.9% in 1988 and 4.3 in 1995 (Recio and Roca 1998: 152).

Importantly, increasing spending on pensions also enabled the government to resort to early retirement schemes to accommodate excess labour. As will be illustrated below, this became an important tool of channelling excess labour in reconverted sectors.

In contrast, spending on unemployment benefits increased only slightly from 2.6% in 1982 to 2.7% in 1988 and back to 2.6% in 1995. Spending on active labour market

policies increased from 7.9% of total expenditures on labour market policies to 17.8% in 1986 and 24.6% in 1989 (Espina 1990: 477). However, this was largely accounted for by spending on employment creation, which included public infrastructure works, rather than programmes designed to incentivise employers or training schemes. Spending on employment creation went from 25% of expenditures on active labour market policies in 1983 to 43% in 1985, while spending on vocational training and incentives to employment decreased from 74% in 1983 to 35% in 1985 (Espina 1990: 470). The focus on public investment was in line with the overall goal of fostering policies that contributed to the public good, and is consistent with accounts of strategies of competitiveness and spending patterns in Spain (Boix 1998). Like with pensions, it ultimately emphasized that the interests of those that were most hurt from liberalization were taken into account to the extent that they did not compromise broader political objectives.

This was also reflected in changes in legislation on unemployment benefits. The Suarez government had introduced the *Estatuto de los Trabajadores* and the *Ley Basica de Empleo* (Employment Act) in 1980, which set up two different levels. The contributory or earnings-related system was (and still is) designed to compensate workers for lost salaries, with the value and duration of contributory benefits dependent on past work experience.¹⁸⁵ Assistance benefits were linked to the minimum wage, and could be received for a limited period by those who had exhausted their entitlement to contributory benefits (Espina 1990: 438-450, Rueda 2007: 185-187). However, this was limited to individuals with family responsibilities, excluding young male and female single workers. This changed somewhat as a result of reform in 1984 that increased the period

¹⁸⁵ Until 1991, the contributory system allowed workers to receive benefits equivalent to half of the period for which contributions had been paid, for a maximum of 24 months. The benefit level was 80% of previous earnings for the first six months, 70% for the next six months and 60% for the second year.

during which contributory benefits could be received and extended the coverage of assistance benefits. Yet this did little to change the fact that a majority of unemployed did not receive any kind of benefit (Recio and Roca 1998: 153).

Moreover, this led to substantial conflict with unions and industrial workers. Workers laid off from reconversion benefitted from a particularly favourable regime of transfers that was, however, only temporary. Moreover, many workers in regions severely dependent on reconversion that were *not* employed in reconverted sectors were nonetheless affected by it, and suffered from cuts in the level of social protection in the normal regime. Unsurprisingly, in many cases this led to labour market segmentation within regions subjected to reconversion processes. Ultimately, the government was “not ready to reach agreements that would have jeopardised growth, investment, state solvency and economic competitiveness” (Maravall 1993: 120). In 1992, further changes were introduced that restricted the period, the level and the conditions of unemployment benefits (Dolado and Bentolila 1992: 13).¹⁸⁶ This was partly aimed at reducing public spending, partly driven by the conviction that unemployment benefits increased unemployment through their effect on labour supply (Recio and Roca 1998: 153). Nonetheless, spending on unemployment in 1995 accounted for the same proportion of GDP as it had in 1982, despite the fact that unemployment had increased from 16.4 to 22.3% of the active population.

Although significant resources were devoted to mitigating the effects of crisis and restructuring in industry, policies were favoured that did not jeopardise general interest policies such as pensions, health and education. This did not benefit concentrated trade losers most affected by restructuring in the wake of liberalisation.

¹⁸⁶ Law-Decree 1/1992, later replaced by Law 22/1992 raised the minimum period of previous work required to be eligible for benefits and lowered the level of benefits. Law 21/1993 and Law-Decree 120/1994 further reduced unemployment benefits, increased the conditions to receive them and restricted them to some workers (excluding part-time workers, for instance).

6.2.2 Compensation and industrial reconversion, 1980-1990

The government's willingness to support policies that contributed to the "collective good", at the expense of those that did not, also had implications for policy specifically designed to address the costs of reconversion. This was already apparent in the debate that followed Law 8/1983, arguably one of the few instances in which policy strayed from the general interest (Navarro 1990).

After publishing the White Book on Reconversion in June 1983, the government approved Law-Decree 8/1983 in November, later sanctioned by the lower house, and which with few amendments then became Law 27/1984 of Reconversion and Reindustrialization of July 26. The new law more clearly articulated the process of reconversion. It included measures for downsizing already present in previous legislation (21/1982), and introduced important features regarding the social protection of workers affected by reconversion. The former included, among others, conditions related to the legal treatment granted to excess labour under reconversion, and arguably constituted one of the few instances in which government policy was subordinated to the wishes of particular groups.¹⁸⁷

Debate revolved around whether to *terminate* or *suspend* the employment relationship of workers in reconverted sectors, and triggered intense conflict between the government and the unions. The government believed that one of the main problems affecting industrial sectors was the presence of structural excess labour, and initially proposed in Law-Decree 8/1983 that downsizing in sectors under reconversion be carried out

¹⁸⁷ Other measures included the possibility of establishing a unified regime of labour conditions in cases of mergers, associations or grouping of companies (art. 18), exemptions of social security quotas for firms in the event of suspension of reduction of work day (art. 19) and conditions for severance pay, which limited the latter to 12 months (art. 20).

through the termination of contracts. The *suspension* of contracts meant workers would continue to receive unemployment benefits, which the government opposed on the grounds that it would detract from the “larger social wage” comprised by pensions and education (Maravall 1993: 110). The main unions (UGT and CCOO) were radically opposed to termination, and conditioned their support on the removal of the termination clause and the inclusion of the suspension of the contract.¹⁸⁸ Strong resistance by unions and ensuing political conflict led the Minister of Industry, Carlos Solchaga, to offer his resignation – which was not accepted – and eventually led the government to withdraw the termination clause from the general framework (8/1984, 27/1984 and subsequent laws governing the employment promotion funds).¹⁸⁹ This opened the possibility that the issue would be addressed in the concrete formulation of the sector reconversion plans.¹⁹⁰

The political debate triggered by Law-Decree 8/1983 also emphasized the limits of regional representation in a context marked by a strong legislative majority in the lower house and the absence of a strong upper house. The government initially decreed Law-Decree 8/1983 and then pushed the draft legislation through the urgent procedure, arguably to enable debate and introduce amendments to the text. Law-Decree 8/1983 had been met with resistance by some Autonomous Communities, concerned about the role of regions in the reconversion process. In contrast to the previous law (Law 21/1982) under the Suarez government, Law-Decree 8/1983 said little about the role that regions were

¹⁸⁸ The *Union General de Trabajadores* (UGT) was the socialist union and had initially supported the government, but relationships worsened throughout the 1980s (Rueda 2007: 118-124). *Comisiones Obreras* (CCOO) had been traditionally linked to the Communist Party, and generally did not endorse government policy.

¹⁸⁹ Tellingly, Solchaga declared in January 1984 that “[The issue over the termination of contracts] is a battle that I have lost... but I have not lost the war. Neither I nor this government have lost it”. *El País*, January 21, 1984.

¹⁹⁰ The problem first surfaced in the special steels sector in January 1984, and set a precedent: after an intense period of strikes and social protest, workers under 55 years that subscribed to the employment promotion funds (to be discussed below) would have their contracts suspended, whereas those over 55 who would access early retirement schemes would have their contracts terminated.

expected to play in the process.¹⁹¹ Although Solchaga made it clear – the day the Law-Decree was sanctioned in Congress – that “in no way [did] the Law-Decree oppose or question the competences that the regional constitutions (or *Estatutos*) granted the regions” (Navarro 1990: 126), the lack of transparency appeared to fuel fears that regional participation would be compromised, at least with respect to the previous framework.

Although a substantial amount of regional demands were met, some of the most important ones were not included in the final bill – which nonetheless enjoyed the support of the regional representatives. Debate revolved around four main issues: the right to declare a sector under reconversion, the right to establish or declare an area of urgent reindustrialization, the extent of regional control of reconversion activities carried out by firms located in particular regions, and the extent to which the fiscal competences characterizing the fiscally autonomous regions (the Basque Country and Navarra) would be compromised. The last two points were pushed through with little conflict. The fiscal and tax-raising competences of the Basque Country and Navarra would not be touched, and the Autonomous Communities would be able to monitor and control how firms in their territories carried out what had been agreed in the reconversion plans (Navarro 1990: 126-128). This outcome was likely favoured by a number of circumstances. The strong electoral performance of nationalist parties in the Basque Country and Catalonia in regional elections at the time, as well as by the constitutional appeals pushed forth by Galicia, the Basque Country and Catalonia, reinforced regional demands.¹⁹² It was also

¹⁹¹ Regions were mentioned only once, in the context of the Areas of Urgent Reindustrialization (AUR). Article 30 stated that the management committee of the AUR would be integrated by representatives of affected Ministries as well as by the corresponding Autonomous Communities.

¹⁹² The *Xunta* of Galicia, the Basque Government and the *Generalitat* of Catalonia appealed against Law-Decree 8/1983 in 1984 (apparent in the Official Bulletin of the State of 3.1.1984, 13.3.1984 and 26.3.1984, respectively). Law 27/1984 arguably corrected some of the deficiencies pointed out by the Autonomous Communities, so that later on both the Basque Country and Catalonia dropped the appeals. However, Galicia appealed against the new law 27/1984 (Official Bulletin of the State 21.11.1984). The

probably shaped by political conflict between the national and regional governments over the LOAPA (*Ley Organica de Armonizacion del Proceso Autonómico*), the first law aimed at harmonizing the decentralization process.¹⁹³

However, the first and second points elicited greater disagreement. The proposal by regional representatives that both the Ministry of Industry and the Autonomous Community jointly declare a sector under reconversion was rejected by the national government. So was the demand that regions be an integral part of the formulation of the reconversion plans. Instead, the region would be informed in all stages of the reconversion process (from inception, formulation and negotiation of the plan, and final draft) and would be present in all units in charge of management, development and implementation of the reconversion plans, but would not participate in their formulation. The proposal that regions be in charge of establishing an area of urgent reindustrialization was also rejected, leading to a compromise solution where the national government and regional administration would jointly do so (Navarro 1990: 127). This strategy was likely driven by the desire by the central government to limit potential opposition to reconversion in particular regions. Solchaga had declared to a Basque daily that “[the Autonomous Communities] must be kept on the side of decisions on reconversion” (*Deia*, 17.7.1983). While the legislative majority enjoyed by the PSOE over the period 1983-1993 facilitated this, the lack of a strong upper house representing regional interests placed policy squarely in line with the priorities of the national government.

ruling of the Constitutional Court 29/1986, however, emphasized that while Law-Decree 8/1983 had fallen short of meeting constitutional guarantees, Law 27/1984 did not. Cf. Navarro (1990: 194).

¹⁹³ Conflict was resolved thereafter in a 1983 ruling (73/1983) by the Constitutional Court, which overrode most of the LOAPA and established that the *Estatutos de Autonomia* (regional constitutions) enjoyed a constitutional status above ordinary legislation. This effectively established the constitutional protection of regional autonomy.

Law 27/1984 introduced new measures designed to compensate for lost employment and foster the reemployment of workers in reconverted sectors. Articles 21 and 22, respectively, set out the right to unemployment benefits of reconverted workers “for the maximum legal period and... independently of the record of contributions to date”, and established the Employment Promotion Funds (EPF) to manage such transfers. Workers who agreed to be part of the EPF received transfers amounting to 80% of average earnings for a period of three years – which contrasted with the 80% coverage during the first six months (subsequently reduced to 60%) and a maximum period of two years in the normal regime. Benefits were not taxed. In addition to increasing the level and duration of benefits, EPF were designed “to facilitate the reemployment of workers affected by reconversion, by means of economically incentivizing the creation of stable jobs and the professional adaptation of excess workers” (Article 22 of Law 27/1984). Article 23 of Law 27/1984 set up a special system of payments equivalent to early retirement transfers and topped up by complementary transfers. Workers over 60 years of age received transfers amounting to 75% of average earnings until they turned 65, and then benefitted from a full pension. Workers from 55 and over could receive transfers amounting to 80% of average earnings, access early retirement schemes at 60 and subsequently benefit from a full pension at 65 (Navarro 1990: 158-159, Espina 1990: 494-495).¹⁹⁴ Such early retirement schemes were also managed by EPF, which were set up for special steels (July 1984), shipbuilding (January 1985), integrated steel (*Altos Hornos del Mediterraneo*, the integrated steelworks in Valencia which closed in 1984, and for *Altos Hornos de Vizcaya* and *Ensidesa* in 1986) and home appliances (January 1985).

¹⁹⁴ The special reconversion regime was funded as follows: the National Unemployment Agency (INEM) funded unemployment benefits as well as social security payments for unemployed workers; the Social Security Institute funded workers under early retirement schemes, while firms topped up transfers for workers over 60 until entry into retirement. The rest was funded by EPF.

A substantial amount of workforce reduction was carried out through early retirement schemes. Table 6.1 shows that a majority of workers in EPF from 1984 to 1986 were over 55. The share of those over 55 in EPF increased until 1989. 65% of workers in EPF over the period 1985-1989 were eligible for early retirement, with the remaining 35% eligible for reemployment (Espina 1991: 500). To the extent that it did not jeopardise the focus on general interest policies, this provided an outlet for those workers close to retirement. But for those under 55, the absence of targeted active labour market programmes made reemployment problematic. A very small proportion of workers under 55 was reemployed. According to data provided by one of the main trade unions (*Comisiones Obreras*, or CCOO), 52% were reemployed in companies outside the sector under reconversion, while 21% were reemployed by the company they had been dismissed from. The remaining workers accepted voluntary redundancies. Although they benefitted from increases in the level and duration of social protection, these measures were only temporary. Given the relatively limited effort in active labour market programmes destined to training, they could do little to promote reemployment. This mattered all the more given workers' frequently insufficient training to operate in productive processes different from their original sector (Navarro 1990: 171).¹⁹⁵ The lack of adequate activation programmes to improve training was particularly harmful among workers with specialized skills who found it difficult to move (Navarro 1990: 187). Interviews also revealed that employers were reluctant to employ workers prone to protest and strike, and were also unwilling to pay the high salaries workers formerly employed in protected industries were accustomed to. The combination of specialised skills and reduced outside options led many workers in specialised regions to subscribe to EPF, but in the absence of targeted active labour market policies, the ability to reemploy such workers was limited.

¹⁹⁵ Accounts have also stressed the unwillingness of workers to abandon EPF. Cf. Pascual 1993.

Table 6.1 Employment promotions funds and excess workers under reconversion in Spain, 1984-1986

	Excess		Enter		Exit		Rest			
	Total	>55	<55	Total	>55	<55	Total	>55	<55	Total
Shipbuilding	14847	4859	8899	13758	93	1291	1384	4766	7608	12374
Home Appliances	6661	1151	1179	2330	13	194	207	1138	985	2123
Special Steel	5558	2657	1389	4046	53	901	954	2604	488	3092
Integrated steel	5891	1363	1266	2629	50	1141	1191	1313	125	1438
Total	32957	10030	12733	22763	209	3527	3736	9821	9206	19027

Source: Annual Report on Spanish Industry, 1988.

The lack of success in reallocating excess workers led the government to extend the period of stay enjoyed by workers in EPF, a process that eventually resulted in their dissolution. The government faced a double conundrum: on the one hand, workers under 55 years in the special steels fund had exhausted the maximum period of 3 years contemplated by Law 27/1984, and a good number of them had not been reallocated to alternative sectors – especially in those funds located in Galicia and the Basque Country, which corresponded to shipbuilding and special steels (Navarro 1990: 168). On the other, the period of validity of Law 27/1984 came to an end on December 31 1986, and the prospects of reemployment of workers in EPF were fairly low. This led to the approval of Law-Decree 341/1987, which extended the period of stay of workers in EPF to a maximum of eighteen months, and set up special access conditions to early retirement schemes. In addition, the new law regulated the conditions under which workers would be bound to accept employment offers. In contrast to earlier laws, this included offers anywhere in the country (provided employment was stable and matched workers' professional skill set).¹⁹⁶ In the event that earnings offered were inferior to

¹⁹⁶ Article 6.3 of Law-Decree 341/1987

previous earnings, the EPF would fund the difference.¹⁹⁷ Other measures encouraged voluntary exit and self-employment, such as guaranteeing redundancy pay in the event of exiting the EPF. Finally, when the problem surfaced again in 1989, the government refused to create new EPF, opting instead for their gradual dissolution. It extended workers' stay in EPF long enough for those under 55 to be able to access the early retirement scheme contemplated in Article 23 of Law 27/1984, it resorted to voluntary redundancies for those workers who had exhausted their period in the EPF and finally transformed the four existing EPF in a pension fund covering the remaining 22000 workers until their retirement at 65.

The government's policy of reindustrialisation exacerbated such problems.

Among the new measures introduced by Law 27/1984 were the Areas of Urgent Reindustrialization (*Zonas de Urgente Reindustrialización*). The AUR were measures of industrial promotion linked to particular areas affected by industrial reconversion, and were explicitly designed to alleviate the social costs of industrial decline. Specifically, they sought to reallocate workers under 55 in EPF in regions reliant on reconverted sectors.¹⁹⁸ The government subsidised investment projects of firms that were required to reserve a quota of jobs for EPF workers under 55. AUR were set up in Asturias, Andalusia (Cadiz), Madrid, the Basque Country (Nervion area), Catalonia (Barcelona) and Galicia (Vigo-Ferrol).¹⁹⁹ Thus, the AUR were designed to facilitate reemployment. According to Law 27/1984, AUR were to be decreed by the government, on the basis of

¹⁹⁷ For the period of time during which workers would have been expected to remain in the EPF.

¹⁹⁸ As pointed out by Velasco (1986: 58), the AUR were distinct from traditional instruments of regional policy (such as development hubs) in a number of ways. First, they focused on industrialized areas subject to intense processes of crisis and decline and were not designed to raise the industrial profile of the region as much as to recompose and reestablish it. Secondly, in contrast to traditional instruments of regional policy, they were only valid for a relatively limited time period. Thirdly, they were limited to the promotion of industrial projects.

¹⁹⁹ Respectively, by Law-Decrees 188/1985 (Asturias), 189/1985 (Cadiz), 190/1985 (Madrid), 531/1985 (Nervion), 914/1985 (Barcelona) and 752/1985 (Vigo-Ferrol). All the AUR were later extended until 1989.

prior agreement with the Autonomous Community. They were to be steered by a managing committee and an executive office in charge of looking for industrial projects and analysing their viability.

Table 6.2 Level and distribution of subsidies across regions, 1988

Area	Subsidy/employment created	Realised investment	Subsidy
<i>Great Areas Industrial Expansion (GAEI)</i>			
Andalusia	1.6	36081	4895
Castile-La Manche	1.6	14116	2583
Castile-Leon	1.7	35526	6095
Extremadura	1.6	4818	807
Galicia	2.4	17208	2680
Total GAEI	1.8	107829	17030
<i>Industrial localisation areas (ZPLI)</i>			
Oviedo pole	0.4	209	16
ZPLI Canarias	1.6	2478	404
ZPLI Valle del Cinca	1.0	444	70
Total ZPLI	1.2	2922	474
<i>Economic Promotion Zones (ZPE)</i>			
Andalusia	8.3	7770	2875
Aragon	7.1	3218	1106
Asturias	2.3	1049	223
Canarias	-	-	-
Cantabria	4.6	4167	837
Castile La Manche	3.6	1015	316
Castile Leon	-	-	-
Ceuta	-	-	-
Extremadura	-	-	-
Melilla	-	-	-
Murcia	5.1	327	72
Total ZPE	5.2	17549	5432
<i>Areas Urgent Reindustrialisation (AUR)</i>			
Asturias	2.1	13598	4822
Barcelona	1.9	56141	12905
Cadiz	1.7	15471	4973
Ferrol	2.1	5591	4478
Vigo	1.6	8309	3573
Madrid	2.7	46743	14023
Nervion	2.8	22165	9517
Total AUR	2.0	172161	54290

Source: *Annual Report on Industry*, Ministry of Industry and Energy 1988, p. 139 (for GAEI, ZPLI, ZPE) and p. 146 (for AUR). Investment is in million pesetas.

Overall, the level of subsidies for the AUR was relatively low. The ratio of subsidies per employment created in AUR for 1988 was somewhat higher than for other instruments of industrial promotion, such as Industrial Localisation Areas (*Zonas de Preferente Localizacion Industrial*). But it was only slightly higher than spending per capita (per

job) for the Great Areas of Industrial Expansion (*Grandes Areas de Expansion Industrial*), which had similar amounts of investment. It was very inferior to the amount devoted to Economic Promotion Zones (see table 6.2).

Moreover, the regional distribution of subsidies in Areas of Urgent Reindustrialisation did not overwhelmingly benefit specialised and uncompetitive regions, where trade losers faced very low chances of reemployment. The share of subsidies targeted to uncompetitive specialised regions was higher than that to diversified regions, both competitive and uncompetitive (column 4 in table 6.3). But given the acute limitations faced by the former in terms of offering employment, the level of subsidies targeted to specialised uncompetitive regions was insufficient. Column 4 in table 6.3 shows the share of government subsidies over realised investment across AUR over the period 1985-1989. The area of Ferrol, in Galicia, very reliant on shipbuilding and scene of the more symbolic episodes of reconversion, received very high levels of subsidies (80%). Ferrol aside, however, the share of subsidies in Asturias, the most specialised and uncompetitive region, was 5 percentage points higher than that of Madrid, and *lower* than that of the Basque Country, both uncompetitive regions with a diversified industry.

Receiving subsidies committed firms to employing workers from EPF who had lost their jobs as a result of restructuring, but the level of subsidies was insufficient to overcome the intrinsic limitations of uncompetitive specialised regions, where the number of EPF workers was greater and the chances of reemployment lower. Of course, levels of investment were higher in the more diversified regions such as Madrid, Basque Country or Catalonia. But this was to be expected: many projects and investments approved in AUR between 1985 and 1989 concerned activities that benefitted from the type of externalities to be found in diversified regions (such as knowledge spillovers for capital-

intensive or design in service activities).²⁰⁰ Yet policymakers appeared not to take this into account when deciding on the level of subsidies to accord projects in particular regions. This had implications for the reemployment of workers in specialised uncompetitive regions. Asturias, Vigo and Ferrol, all three heavily specialised and uncompetitive regions, faced significantly lower rates of reemployment than Madrid, with a much more diversified industrial base (column 7 in table 6.3). Unsurprisingly, in competitive and diversified Catalonia the number of EPF workers that found reemployment was highest. This led some experts to assert that:

“[The declaration of Madrid and Barcelona as AUR] was not necessary. The number of workers under 55 years in EPF in such areas was very small relative to those in the Asturias and Galician EPF, and both [Madrid and Barcelona] possessed important localization benefits and a powerful economic environment that did not require specific measures [such as the AUR] in support of investment”.²⁰¹

Table 6.3. Subsidised investment and employment in AUR, 1985-1989

	1	2	3	4	5	6	7
AUR	Approved	Realized	Subsidy	3/2 (%)	EPF 1987	Offered EPF	Change
Asturias	26178	13598	4822	35	300	637	+337
Barcelona	94841	56141	12905	22	68	2567	+2499
Cadiz	38692	15471	4973	32	235	786	+551
Ferrol	20278	5591	4478	80	1567	666	-901
Vigo	17605	8309	3573	43	668	753	+85
Madrid	90422	46743	14023	30	39	1368	+1329
Nervion	56440	22165	9517	42	2515	778	-1737

Source: Columns 1-4, *Annual Report on Industry*, Ministry of Industry and Energy 1988, p. 146. Investment is in million pesetas. Columns 5-7: Navarro (1999: 170). Data are for the period 1985-1987. Figures in column 4 are in percentages.

²⁰⁰ The distribution of projects and investment by sector approved in AUR shows that of the 843 projects approved, 111 were in the fabricated metal products sector, 100 in the food and beverages sector, 86 in commerce and restaurants, 71 in electronics and 63 in chemicals (Ministry of Industry and Energy 1989). Also, Law 37/1984 initially restricted investment to industrial activities. This was later relaxed, and from 1987 investments in services were also encouraged.

²⁰¹ Navarro (1990: 188).

The strategy of the government to benefit dispersed trade losers did not significantly harm its the electoral prospects. Although relatively low, the benefits of compensation arguably extended beyond those most affected by restructuring. This likely contributed to increased electoral benefits across the board – across most regions. Poignantly, the decision to “grant workers the entire salary until retirement... [meant that] workers in the region would keep going to the bar of the *barrio* to have their beer, would keep buying from the grocery shop round the corner... [One] would maintain demand in the area.”²⁰² Indeed, the government did not suffer significant electoral setbacks in the 1987 municipal elections. As shown by table 6.4, electoral support for the incumbent party in municipal elections across regions did not vary significantly from 1983 to 1987. Regions that featured very high levels of support in 1983 (such as Andalusia, Aragon or Asturias) displayed high levels of support in 1987, while those that displayed low support in 1983 (such as Galicia, traditionally governed by the conservative Popular Party) continued to do so in 1987. Moreover, such voting patterns are not fully consistent with a purely political logic that takes into account electoral competitiveness across regions (Cox and McCubbins 1986, Dixit and Londregan 1998). In contrast to arguments suggesting that incumbents reward either core (Cox and McCubbins 1986) or swing voters (Dixit and Londregan 1998), the downward trend in support for the government in the municipal elections is apparent across traditionally “core” regions, such as Andalusia, or “swing” regions such as Madrid or Catalonia. This qualifies the notion that incentives related to electoral competition are at play, independently of factors related to geographical concentration.

²⁰² Author’s interview, Madrid, March 6, 2012.

Table 6.4. Support for PSOE in municipal elections, 1983 and 1987

Region	1983		1987	
	Votes	Share (%)	Votes	Share (%)
Andalusia	1485502	50.4	1368962	43.6
Aragon	279194	46.7	255985	40.2
Asturias	33859	46.2	228283	39.4
Balearic	105207	33.8	107951	31.7
Canarias	196336	33.8	185924	27.6
Cantabria	9905	35.5	95171	31.8
Castille Leon	547715	40.6	472299	33.3
Castille La Mancha	372713	41.8	371217	39.9
Catalonia	1176518	40.2	1135321	37.2
Valencia	961941	50.4	809619	40.1
Extremadura	276108	49.8	280784	47.0
Galicia	335334	27.4	359165	26.5
Madrid	1171748	50.1	1004033	41.3
Murcia	23449	51.1	215403	42.5
Navarra	75803	29.5	64465	23.3
Basque Country	257285	25.7	201785	18.6
Rioja	58206	43.9	57979	40.8
Total	7683197	43.0	7229782	37.1

In Spain, policy benefitted trade losers in diversified regions (competitive or uncompetitive) at the expense of those in specialised uncompetitive regions. This is consistent with the argument in Chapter 2. In the presence of low demand for compensation, as among losing interests in uncompetitive diversified regions, policymakers had lesser incentives to provide increased compensation. As shown above, subsidy levels in AUR were relatively low. Although they were higher for specialized uncompetitive regions, they were insufficient given the limitations to generate employment faced by such regions.

6.3 Compensation in Argentina, 1989-1995

Chapter 2 claims that the effect of an upper chamber on compensation for a given level of demand varies according to whether regional representatives prefer higher or lower

compensation. Where representatives prefer low levels of policy, the upper chamber is expected to significantly dampen compensation. In contrast, in the presence of representatives that prefer relatively high compensation, the upper house is expected to make less of a difference for policy outcomes. In Argentina, interests from uncompetitive diversified regions that preferred relatively low compensation dominated the upper house. Consistent with the logic of the argument, they succeeded in steering policy towards their interests. However, regional interests with preferences for higher compensation were able to introduce modifications that served their purposes.

Fleshing out the mechanisms underpinning the argument is important for two reasons. First, the analysis in Chapter 4 cannot identify the preferences of legislators, and can only provide a limited basis to test the implications of the argument that relate to upper house bargaining. Second, while insightful, extant arguments on social spending in developing countries do not fully distinguish – theoretically and empirically – between the different mechanisms driving compensation outcomes. Trade has been argued to dampen overall social spending in developing countries due to the latter’s structural dependency on international capital markets, which limits their ability to borrow in bad times and constrains counter-cyclical spending in response to trade shocks (Wibbels 2006). A second argument among scholars of market reform in Latin America posits that powerful labour unions representing labour insiders bargain for increases in social security and organizational power, limiting the provision of compensation to outsiders (Etchemendy 2011, Etchemendy 2004, Murillo 2001).²⁰³ A third argument claims that low levels of social spending result in developing countries because of the weak bargaining position of low-skilled, informal labour (Rudra 2002). However, not all low-skilled workers were informal workers. Workers affected by liberalisation and

²⁰³ Rickard (2012a) argues that governments in developing countries have incentives to provide subsidies rather than welfare spending, but makes no explicit predictions about welfare spending.

restructuring differed in skill level, and were employed in a range of industries that required different skills levels. Finally, a fourth argument attributes low levels of spending on social security in developing countries to trade interests – both employers and workers – empowered by increased trade liberalisation that demand policies that enhance overall competitiveness (such as spending on human capital and education) at the expense of social security (Wibbels 2006: 441-442).

Moreover, the focus on powerful interest groups arguably has analytical implications for how such preferences are represented in the policymaking process. In Latin American countries, in particular, organised labour groups enjoy privileged access to deputies in the lower house, who in many cases are union members running on party lists. Given the connection between interest groups and lower house representatives, such arguments have led to a focus on legislative bargaining in the lower house.²⁰⁴ They thus overlook the role that representative institutions that cater to territorial interests, such as upper chambers, may play in shaping policy. Because of this, such explanations do not unpack the role of preferences, of electoral or legislative institutions.

In sum, low levels of compensation could be the result of electorally motivated policymakers responding to the greater bargaining power of labour insiders (Etchemendy 2011, Murillo 2001, Etchemendy 2004) or of trade sectors wanting policies that enhance competitiveness at the expense of social security (Wibbels 2006), the weak bargaining power of low-skilled labour (Rudra 2002) or, as argued next, the product of legislative bargaining in the upper house. Distinguishing between the mechanisms at work is thus important to better understand the dynamics of compensation in such countries.

²⁰⁴ This refers to studies of compensation or labour market policy. A rich literature on federalism in Latin America focuses on the role of the second chamber. See Wibbels (2005).

As will be shown next, international vulnerability to capital markets did not prevent overall increases in social spending in Argentina – though not compensation. More importantly, the existence of powerful labour interests did not prevent policymakers from targeting outsiders. In the upper house, regional legislators with a preference for compensation were, despite opposition from a majority of regions, able to shape policy in a manner consistent with expectations. Further, in the absence of regional pressures, the government was able to target employment programmes to concentrated trade losers. This qualifies arguments based on the bargaining power of insiders in dualised labour markets (Etchemendy 2011, Rueda 2007).

The analysis of compensation in Argentina has an important caveat. Structural adjustment called for deep reforms on a number of different economic fronts at the same time. Like in many Latin American countries during the period, this led to policy bundling. In particular, many such countries introduced “packaged” measures to address the labour market effects of structural reforms. In Argentina, tackling the effects of structural reforms involved the bundling of labour market deregulation and the protection against unemployment. Admittedly, this opens the door to second dimensions that may modify preferences for compensation. In the Argentine context, this had implications for industrialised (uncompetitive specialised) regions, which had more to lose from labour market flexibility. As argued below, given the regional structure of interests, it is unlikely that the outcome would have been different in the absence of labour market flexibility.

6.3.1 Compensation under macroeconomic adjustment

In early 1989, the Argentine economy was in the midst of severe economic crisis. The country was suffering from acute fiscal crisis, a heavily indebted state facing increasingly unfavourable borrowing rates and very low levels of international reserves.

Much of this could be traced to the drying up of external credit in the early 1980s (Gerchunoff and Torre 1996). Capital flows “reversed course abruptly from the net new borrowing (new outflow) before 1982 to the servicing of outstanding debt (net outflow)” in 1982 (Frieden 1991: 216). In the early 1980s, the military dictatorship pursued a combination of macroeconomic policies that alienated business groups and increased political instability (Schamis 1999). In 1976, the regime liberalised prices, decreased import tariffs, reduced export taxes in an attempt to increase economic efficiency and weaken the protectionist demands of organised groups strengthened by ISI (Schamis 1999). It also deepened stabilisation policies to reduce inflation by implementing an exchange-rate policy based on an active crawling peg. The policy of preannounced currency devaluations, known as the *tablita*, was accompanied by the elimination of restrictions on the trade and capital accounts (Machinea 1990). The preannounced exchange rate was set at below-inflation rate levels to reduce inflationary expectation, and increased real appreciation (Schamis 1999). Currency appreciation and oversupply of foreign credit led to the accumulation of trade deficits and a run on the currency in 1981 (Frieden 1991, Schamis 1999). The political instability that followed led to the cessation of credit in 1982 (Frieden 1991: 215). This directly affected the supply of foreign exchange, capital and government finances. Increased interest rates severely constrained government expenditures under the dictatorship and fuelled political instability. Intermittent programmes of orthodox economic policies, first in 1981 under Economy Minister Martinez de la Hoz and then under Roberto Alemann, proved to be increasingly unpopular (Frieden 1991: 224-226). The invasion and defeat of the Falklands in 1982 paved the way to transition government. The transitional military government that took over in 1982 sought to placate business and labour groups in an attempt to reverse the tainted image of the military (Frieden 1991: 226), and bailed out

indebted firms and increased real wages. As a result, the incoming government of Raul Alfonsin, elected in 1983, faced an economy in disarray.

Concern with meeting the social demands of democracy initially displaced the focus on economic reform (Palermo and Novaro 1996: 13-14). Growing inflation and awareness of the depth of fiscal crisis prompted the introduction of the Austral Plan in 1985 (Palermo and Novaro 1996: 15). The plan was intended to “control inflation without economic contraction” (Frieden 1991: 227), and included reductions in the budget deficit, a wage-price freeze, a new currency and a restrictive exchange rate. Partly due to lack of social and political support, however, reform efforts were half-hearted and failed to address underlying problems (Palermo and Novaro 1996: 15). The new government was reluctant to engage in necessary reforms for fear that conflict with the unions and business would induce rapprochement between the latter and the military (Palermo and Novaro 1996, Schamis 1999). Increasing inflation, falling real wages and declining employment triggered demands for relief by social groups, while at the same eroding revenues in the formal sector. Fiscal policy also altered the tax base of the pensions systems, increasing social security debt (Beccaria and Carciofi 1995: 224). Yet government access to external sources of finance had by then been cut off, leading the government to finance spending by inflationary means (Frieden 1991: 226-227). Social expenditures in real per capita terms rose steadily between 1983 and 1987 and were on average 8% higher than during the previous decade (Beccaria and Carciofi 1995: 201-202).²⁰⁵ By late 1987, inflation reached 300%, the deficit rose, and the government lost the midterm elections. In October 1988, it lost the presidential elections to the Peronist Party.

²⁰⁵ Public spending averaged about 20% of GDP during the period 1980-1990.

Faced with acute fiscal crisis and in need of external funds, the incoming government led by Carlos Menem embarked on a broad programme of economic reforms. The macroeconomic situation left the government few options. Attempts to stabilise the economy in the wake of the debt crisis had repeatedly failed, and the support from external (and internal) economic actors was badly needed to secure economic solvency (Stokes 2001, Gerchunoff and Torre 1996). In addition, in 1987 the Alfonsín government had committed to structural reforms by entering an agreement with the World Bank. Macroeconomic vulnerability made the government even more vulnerable to pressures for reform from the international community (Cortes and Marshall 1999). In sum, fiscal crisis in the absence of external credit left the incoming government in 1989 with little choice but to embark on a wide project of macroeconomic adjustment to avoid economic collapse (Torre and Gerchunoff 1999: 5, Torre and Gerchunoff 1996: 737).²⁰⁶

If borrowing constraints in the context of fiscal crisis triggered reform, domestic economic conditions arguably shaped the characteristics of reform (Gerchunoff and Torre 1996). The acute fiscal crisis facing the country made securing economic solvency the main macroeconomic priority. Structural reforms were thus designed to complement stabilisation with a view to reducing the deficit and containing inflation, with the goal of long-term competitiveness coming second (Gerchunoff and Torre 1996: 739). The wave of structural reforms undertaken by the Menem government in July and August 1989 involved privatisation, tax reform and trade liberalisation, and were embodied in the *Ley de Emergencia Economica* and the *Ley de Reforma del Estado* discussed in Chapter 5. Privatisation was designed to increase revenues and increase international credibility, and involved the selling of state assets to a variety of international and national market

²⁰⁶ Gerchunoff and Torre argue that the problems underlying the fragile macroeconomic context – the fiscal crisis and the lack of external credit – arguably “explain the opportunity and depth of government policy” (Gerchunoff and Torre 1996: 737). This echoes recent research on the determinants of market reforms in developing countries (Doyle 2010, Meseguer 2004).

actors, arguably with little regard to process or selling conditions (Etchemendy 2011). The reform of the tax system sought to increase revenues by extending the fiscal base of indirect (and later direct) taxes, eliminating subsidies to industrial promotion and fighting tax evasion (Carciofi, Barris and Cetrangolo 1994). In turn, trade liberalisation involved a stark reduction of trade barriers and the elimination of non-tariff barriers. The average (nominal) tariff was reduced to 26% in 1989 and to 17% at the end of 1990. In March 1991, a tiered structure was introduced that set tariffs to 0% for raw materials, 11% for intermediate goods and 21% for final manufactured goods. As a result, the average tariff dropped to 10%.

Other factors contributed to the adoption of reforms. Menem's electoral triumph had unified an otherwise fragmented party behind him. This was compounded by a "Nixon goes to China" effect that bolstered credibility, even if, "in truth, the fiscal crisis and the need to gain international reputation in the eyes of the international business community did not leave him any other alternative" (Gerchunoff and Torre 1996: 738). In addition, the experience of hyperinflation had dampened opposition to broad market reform (Baker 2010, Gerchunoff and Torre 1996). Hyperinflation discredited existing economic institutions and increased "social tolerance to adjustment", thereby providing a political opportunity to set the economy on a radically different course (Gerchunoff and Torre 1996: 737). In effect, the macroeconomic environment weakened social demands that did not contribute to economic stability (Sanchez Sibony 2011: 103, Baker 2010).²⁰⁷

Global support for macroeconomic adjustment, however, did not prevent affected interests from pressuring policymakers in order to define and decide on the overall outline of reforms (Torre and Gerchunoff 1999). As will be shown below, interests

²⁰⁷ This echoes research on market reforms in Latin America arguing that in extreme conditions, consumer interests may prevail over producer interests (linked to employment) to determine support for market reforms (Baker 2010). It also echoes research emphasising that governments benefit from the broad acquiescence to reform from a public likely convinced that despite the costs, reforming the status quo is the best possible alternative (Bruszt 1995).

affected by liberalisation opposed reductions in social spending, and sought to protect compensatory measures.

Inflation was initially addressed through deficit reductions, changes to the exchange rate and negotiated incomes policies with employers. In March 1990 – in the wake of two hyperinflationary episodes – the government implemented a highly restrictive monetary policy and eliminated capital controls to promote investment, but the emission of money to finance the deficit led to a new speculative attack on the currency, triggering another inflationary spike. Failure to control inflation led to a second wave of reforms focused on stabilisation. The introduction of the Convertibility Law in March 1991 (Law 23928), designed to slash inflation and help close the fiscal gap, largely succeeded in doing so. The law established a fixed exchange rate, forced the Central Bank to convert pesos freely into dollars and prohibited it from printing money to cover deficits unless new currency issued was backed by foreign reserves. As a result, inflation plummeted from a 27% monthly rate in February 1991 to less than 1% a few months later. Moreover, high interest rates also attracted foreign credit, increasing bank deposits, internal credit and expanding consumption (Gerchunoff and Torre 1996: 747).

Convertibility improved the macroeconomic context in the short run, leading to sustained increases in growth for the next three years. GDP grew by 7.7% between 1991 and 1994, consumption expanded by 40% and investment in manufacturing (machinery and equipment, mostly) also benefitted from the inflow of foreign capital. Increased demand also led to an increase in revenues in late 1992 and early 1993 (Gerchunoff and Torre 1996: 748). On a distributive level, however, the effects of convertibility were varied. Low-income citizens saw an increase in purchasing power, while the middle classes faced increases in the price of private (health and education) and public services, which they consumed relatively more of. But sectors exposed to trade were significantly

hurt. The nominal exchange rate anchor led to an appreciation of the exchange rate, which increased imports and hurt manufacturing exports. In such sectors “domestic economic expansion had an almost negligible effect” (Gerchunoff and Torre 1996: 748). Moreover, by introducing wage rigidities, convertibility led firms to adjust to the change in relative prices through employment. This led to a reduction of employment and a drop of real wages in industry of 10% between 1991 and 1994. Moreover, in the context of the high levels of debt faced by Argentina, it introduced further economic uncertainty (Gerchunoff and Torre 1996: 747).

Given existing low levels of compensation at the onset of liberalisation discussed in Chapter 5, workers that stood to lose from trade had good reasons to support measures that lessened the incidence of unemployment. Since workers affected by trade were unevenly distributed across regions, political conflict over compensation was likely to reflect regional demands. Particularly in the upper chamber, where regional senators had greater incentives to represent regional interests. One of the first instances of this concerned labour market reform, proposed by the government in 1990 in the wake of growing levels of unemployment (Etchemendy and Palermo 1998: 567). Representatives of specialised uncompetitive and competitive specialised interests were able to introduce modifications that increased social protection.

6.3.2 Bargaining over compensation

The *reforma laboral* (labour market reform), as the National Employment Law came to be known, sought to introduce flexibility in a highly regulated labour market and increase the very low levels of unemployment protection. Argentina’s labour market was among the more regulated in the region, with stable open-ended contracts and high redundancy payments as the norm, centralised collective bargaining and high levels of employer contributions to social security. The reform aimed to reduce labour market

costs and increase the freedom to end employment, both seen as major tools to address unemployment and competitiveness without incurring a nominal devaluation (Marshall 1997).²⁰⁸ Decreased redundancy payments and flexible contracts threatened entrenched labour interests that benefitted from a protected labour market with access to generous social benefits. In parallel, the bill also introduced a system of unemployment benefits and a range of employment programmes, intended to address growing unemployment.

The bill was initially sent to Congress in January 1990. The government chose to start the process in the Upper House in the hope of encountering less opposition (Torre and Gerchunoff 1999: 32). Despite the majority enjoyed by the government in both houses, reform was likely to face greater opposition in the lower chamber. Labour market flexibility had stark implications for the economic and political power of unions, who were directly represented in the lower house through their inclusion in the PJ's electoral lists. In the Senate, support was crucially dependent on its "peripheral coalition" (Gibson and Calvo 2000). Such provinces were generally economically backward regions "with negligible proletarian populations and ... rural electoral bastions (Gibson and Calvo 2000: 36). Buenos Aires, Cordoba and Santa Fe (and Mendoza) concentrated 78% of industrial production and 70% of the population. The remaining regions were relatively underpopulated. Given the Argentine's Senate strong overrepresentation, this granted them substantial political influence. With only 30% of the national population, the peripheral regions held 40 of 48 seats in the Senate, or 83% of the total (Gibson and Calvo 2000: 35). Importantly, under the 1994 Constitution, senators were indirectly elected by each provincial legislature, so that provincial legislatures determined the composition of the national Senate. From 1989 to 1991, the government controlled 17

²⁰⁸ Later reforms further limited employment protection: Law 24467 ("Statute for Small and Medium Enterprises") passed in March 1995 and Law 24465 introducing new forms of flexible contracts were among the most significant pieces of legislation in terms of labour market flexibility (Etchemendy and Palermo 1998: 573).

out of 22 provincial governorships and enjoyed the support of conservative provincial parties (Gibson and Calvo 2000).²⁰⁹ This had “bolstered the governing capabilities of the Peronist party” in the Senate (Gibson and Calvo 2000: 39), and had enabled it to push through important reforms at the expense of the larger regions.

The regional distribution of interests in favour of compensation, however, was arguably not very favourable to the government. Specialised uncompetitive regions benefitted from the introduction of unemployment benefits and activation programmes. A substantial number of peripheral regions were reliant on the agro-industry, but not all were uncompetitive. In specialised provinces such as Tucuman, Santa Cruz, Chubut, Misiones, La Pampa, Jujuy, Tierra del Fuego, Entre Rios, Rio Negro, San Juan and Chaco, agro-industry accounted for more than 40% of regional employment. But provinces such as Tucuman, Misiones, Jujuy, La Pampa or Entre Rios were on average more uncompetitive than Rio Negro, San Juan or Chaco, and would have benefitted from the introduction of benefits or activation measures. Specialised competitive regions such as Rio Negro or San Juan (or Chaco) had incentives to demand some compensation, but their behaviour was variable. In some regions, the costs of specialisation could be expected to be higher than the gains of competitiveness.

Although *convertibilidad* had stabilised the currency, exports in the agro-industry were nonetheless exposed to higher levels of price volatility than standard manufacturing activities (Huchet Bourdon 2011), particularly in products such as sugar and cereals.²¹⁰

This made specialised competitive regions such as Rio Negro vulnerable to increased uncertainty. In others, however, there was less reason to expect support for

²⁰⁹ Between 1991 and 1995, it controlled 14 out of 23 governorships (Gibson and Calvo 2000: 38).

²¹⁰ This echoes arguments that expect tradable interests to oppose cuts in social spending during negative shocks and support cuts on social security rather than human capital during positive shocks (Wibbels 2006). Arguably, the positive shock triggered by the currency peg should have led to greater confidence among tradable sectors, leading them to support cuts in social security rather than human capital. However, price volatility in agricultural commodities was still relatively high. This may explain some support for social security among the agricultural regions.

compensation. Chaco, for instance, was mostly dependent on textiles rather than food, while San Juan was largely reliant on the production of high-quality wine exported to developed countries, and benefitted from economic recovery (Allub 1996).

As illustrated in Chapter 5, however, the peripheral provinces were economically heterogeneous, and many such regions had little industry to speak of. Regions such as Corrientes, Catamarca, Formosa, La Rioja, Neuquen, Salta and Santiago del Estero were uncompetitive and diversified, and low levels of competitiveness reflected the relative absence of productive activities, in both agriculture and industry. Such regions arguably had few incentives to support compensatory measures from which they would benefit little. The more industrialised regions also exhibited variation. Cordoba and Santa Fe were heavily dependent on unproductive, capital-intensive industries, and as shown in Chapter 5, faced pressures to provide compensation. In contrast, Mendoza and San Luis were uncompetitive but diversified regions, whose relatively dynamic labour market offered outside options and thus faced less need for compensation. Overall, only 10 out of 24 regions had reasons to support compensation. The rest either supported low compensation (diversified uncompetitive regions) or were too heterogeneous (specialised competitive regions).

Admittedly, the linking of labour market reform and compensation introduced a second dimension that tilted the balance even further towards low compensation. Policy bundling meant that opposing labour market flexibility would have entailed opposing compensation. To the extent that they were both viewed as tools against unemployment, both were framed as complementary. Labour market flexibility had greater implications for the industrialised regions. Cordoba and Santa Fe were heavily dependent on unproductive, capital-intensive industries, and would have welcomed relief from the costs of liberalisation. But they were also heavily populated, and greater flexibility

would have deprived industrial workers from generous social benefits. This may have led such regions to accept lower compensation in exchange for protection of the labour market.²¹¹ This was even more apparent in Buenos Aires, whose diversified industry made flexibility a threat to broader groups of voters, and where relatively high competitiveness decreased the need for compensation. Among the peripheral regions (uncompetitive and competitive specialised regions), opposition to labour market flexibility was not very salient. Although reliance of such regions on public employment made them vulnerable to increased flexibility, cuts to public employment in the provinces were not undertaken until 1994 (Gibson and Calvo 2000). Support for compensation was thus concentrated among the group of peripheral specialised uncompetitive regions, while opposition to flexibility was widespread. Since the former were numerically inferior, this likely tilted the balance further towards even lower compensation. The fact that the pro-compensation coalition was in a minority to begin with, however, makes the possibility that the anti-compensation coalition would have been outnumbered in the absence of policy bundling unlikely.

The bill met with obstacles from the start. Representatives of worker interests controlled the Employment and Social Affairs Committee in both houses, “the compulsory tollbooth in the passage of bills on labour reform” (Torre and Gerchunoff 1999: 32). This gave worker interests “veto power that would serve to compensate loss of union power in economic and political terms, and rebalance the influence of the main promoters of reform, the employer associations” (Torre and Gercunoff 1999: 32). Initially, the proposal included measures on a number of issues. These ranged from the introduction of limits to redundancy pay (the Law of Economic Emergency passed in July 1989 had ruled out limits in article 48), the introduction of new forms of temporary

²¹¹ Unfortunately, debates in the Employment and Social Affairs Committee are not available.

contracts that waived social security contributions and decreased redundancy payments²¹², management of firms' debt to social security and issues related to work accident legislation.

From the beginning, the proposal met with opposition from uncompetitive and competitive regions alike. Senators across the board objected to the proposal that social security debt be reduced by 50% for employers that legalised their employees, as this would severely affect financing of social security, which mainly comprised pensions (Torre and Gerchunoff 1999: 32). In particular, senators from uncompetitive and specialised regions such as Cordoba and Santa Fe had good reasons to oppose cuts. In addition to being very populated, cutting on pensions would have contributed to greater discontent among constituents benefitting from early retirement schemes as a result of restructuring. A majority of regions also warned that the introduction of fixed time contracts contemplated by the proposal would enable firms to retain their best workers and dismiss others to re-employ them in precarious conditions (Torre and Gershunoff 1999: 32). In the face of such objections, the bill failed to gather support.

In December 1990, the government chose to remove the bill from the Senate Committee, and sent two new bills instead. The first concerned issues related to work accidents, which in principle were less divisive. This bill did not introduce significant changes to existing legislation, established employers' responsibility for accidents during work and placed a limit on the amount of compensation. The second bill, the Employment Law, once again elicited greater criticism. It deregulated the labour market through "promoted (temporary) contracts" that waived social security contributions and set a limit to

²¹² Particularly for workers with short tenure, for whom the cut exceeded 50%. So called "promoted" contracts such as temporary or fixed time contracts (from 6 months to 2 years) allowed employers to hire without redundancy pay for workers with more than 3 months in the post, as set out in the Law of Employment Contracts. Most of the promoted temporary contracts were eliminated by a new reform in 1998, but at the same time considerably reduced lay-off compensation, which had been raised in 1989 and reduced in 1991. Cf. Marshall (1997).

redundancy payments. It also created a system of unemployment benefits intended to provide protection in a context of growing unemployment (Etchemendy and Palermo 1998: 567). A National Fund for Employment (*Fondo Nacional de Empleo*) was created to fund unemployment insurance and employment programmes. The Fund would be financed by contributions previously allocated to family allowances (1.5%) as well as other contributions (3% of total salaries paid by employers of temporary agencies), state funding (through some budget items) and donations or private sector subsidies.²¹³

In March 1991 and in the wake of *convertibilidad*, Finance Minister Domingo Cavallo prompted Senators for a quick decision on the law. Representatives from Cordoba and Santa Fe as well as Buenos Aires once again refused to condone employers' debt to social security (Torre and Gerchunoff 1999: 33).²¹⁴ Together with the larger regions, some peripheral regions also sought to limit flexibility by conditioning the use of temporary contracts to approval by the unions in collective bargaining.²¹⁵ Among them were Catamarca, Formosa, Santiago del Estero and Corrientes. A majority of senators opposed limiting redundancy payments, as proposed by the bill (Torre and Gerchunoff 1999: 33).

However, the text also included changes that reflected regional demands for compensation. The provision of unemployment benefits was maintained, albeit with limitations. The scope and coverage of benefits was limited. An article was included to extent unemployment insurance to agrarian workers.²¹⁶ The original bill was restricted to formal sector workers, and excluded domestic, rural and public sector workers from the

²¹³ This amounted to around 0.2% of GDP in 1993, or 434.6 million pesos, of which 76% went to unemployment benefits and the rest to employment and training programmes (Cetrangolo and Golbert 1995).

²¹⁴ *Diario de Sesiones. Camara de Senadores de la Nacion. 59ª Reunion, 16ª Sesion Extraordinaria*, 17-18 April 1991.

²¹⁵ Unfortunately, data to verify which regions did so is not available.

²¹⁶ *Diario de Sesiones. Camara de Senadores de la Nacion. 59ª Reunion, 16ª Sesion Extraordinaria*, 17-18 April 1991, p. 6491.

system of unemployment benefits. While formal workers in the agricultural sector were covered by a separate regime, the level of benefits was more generous under the new law. In addition, their exclusion from the Employment Law deprived them of eligibility for public employment programmes.²¹⁷ Competitive specialised regions had good reasons to demand unemployment insurance to cover agrarian workers. The currency peg that followed approval of the Convertibility Law had brought about relative macroeconomic stability.²¹⁸ However, currency appreciation had also negatively affected agricultural exports, and volatility in commodities was still higher than in manufacturing (Huchet-Bourdon 2011). The extension of insurance to agrarian workers effectively benefitted workers in the more agro-industrial regions as well as the more agricultural regions that were suffering from the adverse effects of trade and currency appreciation. Consistent with the argument, specialised regions facing greater vulnerability to a possible decrease in regional competitiveness pushed for the inclusion of compensation. With these amendments, in April 1991 the bill went through the first part of the legislative process and was sent to the lower house.

The bill met with even more resistance from representatives in the lower house. However, conflict in the Chamber of Deputies was based less on regional interests and more on class lines (Etchemendy and Palermo 1998). Despite the government's legislative majority (or arguably because of it), conflict cut through party lines and divided peronist deputies in favour of reform and the *diputados sindicales*, union leaders linked to the Peronist Party and traditionally present in the PJ's electoral lists, against it. The union movement in Argentina had been traditionally linked to the Peronist

²¹⁷ Formal workers in agriculture were covered by the *Régimen Nacional de Trabajo Agrario* (or National regime of agrarian employment, Law 22.248, passed in 1980).

²¹⁸ This likely led to greater confidence among tradable sectors, which thereby benefitted from exchange rate stability – and could have been expected to prefer cuts to protection of social security spending rather than to human capital (Wibbels 2006: 442).

movement, and dominated organised labour (Levitsky 2003).²¹⁹ Unions in Argentina had high membership rates, played an important role in wage setting and were organizationally strong (Etchemendy 2011, Murillo 2001). Their centralised structure and monopoly of representation enabled them to extract concessions from the government in a number of key reform areas such as health and pensions and labour (Etchemendy 2011).²²⁰ Nonetheless, the fact that conflict along regional lines was absent in the lower house and present in the upper house suggests that policymaking that incorporates an upper house has the potential to yield different outcomes (Wibbels 2005, Beramendi 2012). This arguably qualifies existing arguments, which implicitly assume that tradables' preferences for lower compensation drive outcomes (Rudra 2002) or that interests affected by liberalisation exert their bargaining power exclusively through the lower house (Etchemendy 2011).

The large presence of *diputados sindicales* posed a serious challenge to approval of the bill (Torre and Gerchunoff 1999: 32, Etchemendy and Palermo 1998). As soon as the bill reached the lower house, the union deputies used the Employment and Social Affairs Committee of the Chamber to delay the bill until the government pledged to bail out the unions with public subsidies (Torre and Gerchunoff 1999: 33). After two failed attempts by the Peronist majority to debate the bill on the floor, in August 1991 the government vetoed an article of the Law on the Consolidation of Internal Debt, thereby cancelling the advantageous conditions to pay public debt held by the unions. Conditioning the

²¹⁹ Etchemendy and Palermo (1998: 567) argue that the unified position of the unions, which had been split in their support for (CGT-San Martin) and against (CGT-Azopardo) Menem's policies, was mainly due to the class-based character of labour market reform, which rallied unions in defense of labour rights and against flexibility.

²²⁰ Recent research argues that the strength of union movements as well as regime shape the type of compensation targeted to those affected by restructuring (Etchemendy 2011). Unions in Argentina were not only major coalition partners in the governing coalition, but were also able to extract measures that guaranteed their organisational survival (cf. Murillo 2001). Etchemendy and related arguments, however, do not look at the role of legislative bargaining across houses, and do not consider the possibility that regional interests may co-exist alongside class interests. To the extent that they do, the argument developed in this research is not inconsistent with such arguments.

cancellation of unions' debt to their support on the Employment Law had immediate effects. The union deputies in the Chamber pledged to support labour reform in return for governmental subsidies (Torre and Gerchunoff 1999, Etchemendy 2011: 169). The bill was sanctioned by the upper house in August, but faced a number of twists thereafter. When the government won a clear victory in the legislative elections in September – the first elections after the Convertibility Law – it resumed negotiations with the union deputies. Strengthened by the election results, the government was able to expand the period of implementation of the new temporary contracts and limit redundancy payments, but was not able to change the clause that subjected the use of temporary contracts to approval by the unions (Torre and Gerchunoff 1999: 33).

Such political constraints arguably eclipsed concern for compensatory measures among the union deputies (Etchemendy and Palermo 1998, Murillo 2001). However, non-union deputies across the partisan spectrum criticised the absence of active labour market policies and raised objections against the limited coverage of the new unemployment insurance regime. Such objections came precisely from deputies from three uncompetitive regions: Cordoba, Santa Fe and Formosa (the latter less specialised than other two). Deputies from Cordoba's *Union del Centro Democrático* criticised the creation of an "unemployment fund that [was] not paralleled by a policy to recycle labour moving from one sector to another".²²¹ Other deputies criticised the limited scope and coverage of unemployment insurance.²²² The bill limited the period of benefits to 12 months, and established that the amount of benefits be calculated as a percentage of highest earnings in the six months before termination of the contract. This granted discretion to the National Council of Employment, Productivity and Minimum Salary,

²²¹ *Diario de Sesiones. Cámara de Diputados de la Nación. 37ª Reunión, Continuación de la 11ª sesión ordinaria*, 26-27 September 1991, p. 3259.

²²² In addition to the exclusion of domestic and public sector workers, workers had to be dismissed without cause to benefit from transfers – most were dismissed with cause.

created by the bill, to decide on such amounts – as was later the case.²²³ Finally, deputies from Formosa raised objections to the fact that the bill granted discretion to the Ministry of Employment to declare a state of “occupational emergency” in areas facing restructuring. Since this enabled the government to then target public employment programmes to such areas, the article opened the door to potential targeting by the executive at the expense of groups that needed it most.²²⁴

The lower house approved the bill in October 1991, and shortly after the Senate approved the changes made in the lower house. In the end, the opposition in the Senate was split: the small provincial parties voted with the Peronist Party in favour of the bill, while the Union Civica Radical voted against it. Given the otherwise unified support of provincial parties from the agricultural regions enjoyed by the government, opposition to such aspects of the bill emphasized the limits of partisan affiliation. This is not to say that other factors such as population or partisan affiliation did not matter. The partisan division of support for the Employment bill illustrates they did. Demographic factors likely also played a role, since the more industrialised regions such as Cordoba, Buenos Aires or Santa Fe were heavily populated. That conflict cut across populated and underpopulated regions as well as affiliated regions, however, suggests that it was not the only thing that mattered.

²²³ From September 1994, the amount of benefits was reduced to 50% of the highest earnings during the first four months

²²⁴ *Diario de Sesiones. Camara de Diputados de la Nacion. 37^a Reunion, Continuacion de la 11^a sesion ordinaria*, 26-27 September 1991, p. 3255.

Table 6.5. Social Spending in Argentina, 1980-2000

1	2	3	4	5	6
Year	Unemployment	Total	Social Security	Services	Employment
1980	4.0	16.09	9.13	6.96	0.79
1981	5.2	17.21	10.27	6.93	0.52
1982	6.1	12.54	7.41	5.13	0.35
1983	5.0	12.88	7.13	5.75	0.46
1984	5.0	14.09	7.52	6.57	0.40
1985	7.3	16.75	9.51	7.24	0.46
1986	7.0	17.56	9.77	7.79	0.70
1987	7.1	18.88	10.53	8.35	0.61
1988	7.3	16.46	9.14	7.32	0.36
1989	9.3	17.47	10.47	7.00	0.37
1990	9.1	17.53	10.75	6.78	0.39
1991	7.6	17.94	11.05	6.89	0.68
1992	7.9	18.31	11.08	7.23	0.62
1993	11.2	18.49	10.75	7.74	0.80
1994	13.1	19.07	11.23	7.84	0.85
1995	19.1	19.47	11.64	7.83	0.95
1996	18.7	18.29	10.83	7.46	0.89
1997	16.5	17.58	9.98	7.6	0.82
1998	14.9				0.77
1999	15.4				0.89
2000	16.5				0.85

Sources: All data in % of GDP. Total social spending and disaggregated spending on social services and social security is taken from Ministerio de Economía y Obras y Servicios Públicos (1999), *Caracterización y Evolución del Gasto Público Social, 1980-1997*. All other data are taken from Bertranou and Paz (2007) and the Directorate of Analysis of Public Spending and Social Programmes, Ministry of Economy.

Political conflict had implications for the level of compensation. Relative to other social spending, the share of spending allocated to unemployment protection was very limited. Table 6.5 shows consolidated spending data over the period 1980-2000. Spending on social security – comprising pensions, health, family allowances and unemployment benefits – increased by 1 percentage point during 1989-1995, but most of it was driven by increases in pensions and health. In 1995 alone, 56.8% of social security spending went to pensions, 21.9% to health and 1.1% to

unemployment benefits (Bertranou and Bonari 2005: 81-84).²²⁵ Social expenditure increased by 2% from 1989 to 1995, when rates of unemployment peaked to almost 20%, and decreased slightly thereafter.²²⁶

Does the theorised relationship between institutions and compensation hold in the *absence* of regional veto players? As discussed earlier, the National Employment Law set up a number of public employment programmes that were intended to generate “large-scale employment for a fixed amount of time, through direct employment by the state, for the execution of public works or the provision of services of national and social value, and labour intensive” (Art. 108, Law 24013). Importantly, although the National Fund for Employment set up by the Law was originally destined to finance unemployment benefits, though Law 24013 contemplated the possibility that leftover funds could be used to finance active labour market policies.

Among them was the *Programa Intensivo de Trabajo* (PIT, or Intensive Work Programme), launched in 1993. A range of programmes followed it, amongst which was the *Plan Trabajar*, which enjoyed three different versions from 1996 until 2001. Both were targeted to the unemployed with no access to benefits, which included workers in the informal sector and workers in the formal sector who were too young to have accumulated contributions, or those that did not have family. The Ministry of Employment and Social Affairs could declare a state of occupational emergency in productive sectors or particular regions on economic, technological or natural disaster grounds (Art. 106). Thus, implementation of the programmes was decided upon and coordinated by the national government, and administered by the provinces. In the

²²⁵ Health corresponds to the *Obras Sociales*, health agencies managed by the unions.

²²⁶ This is consistent with accounts claiming that social public expenditure was mostly anti-cyclical during the period (Bertranou and Bonari 2005).

absence of legislative oversight, the government was able to target policy to its preferred constituents.

The Argentine government faced a different set of electoral incentives than policymakers in the upper house. Elected by plurality rule, the government arguably faced relatively strong incentives to target policy to trade losers that were geographically concentrated. This included trade losers in specialised regions, both uncompetitive and competitive. Trade losers in specialised competitive regions faced conflicting forces, since they benefitted from competitiveness but faced greater risk in the event of a shock. As illustrated above, workers in regions reliant on agricultural activities, both manufacturing and primary, had been adversely affected by currency appreciation, and despite greater currency stability, nonetheless faced greater price volatility than other sectors. This arguably led to demand for compensation, driving political incentives to target such trade losers. Column 6 in Table 6.5 provides some support for this. Spending on employment programmes went from 0.37 % to 0.89 % over the period 1989-1999, reaching high levels in 1995, at the peak of unemployment. Spending in this category included unemployment benefits, active labour market policies and family allowances.²²⁷

Data on the regional distribution of employment programmes in the aftermath of the National Employment Law for 1994 make it possible to gauge the extent to which political incentives in the absence of regional veto players shaped the distribution of compensation. Focusing on the PIT provides a number of advantages. Although data on subsequent programmes (such as the *Plan Trabajar*) is available, such programmes were co-financed with international institutions such as the World Bank

²²⁷ Family allowances were mainly child benefits that included allowances to support schooling, but also comprised one-off payments for births, maternity or disability of children. Unfortunately, excluding family allowances is not possible, but research of social spending data indicates that under half of spending on employment was accounted for by family allowances (Bertranou and Bonari 2005).

or the International Development Bank. In contrast, the PIT was entirely funded by the *Fondo Nacional de Empleo* set up by the Employment Law (Giraudy 2007). This dampens concerns that external funding blurred accountability. Under the PIT, the federal government sent funds to provincial governments, which would then be directly allocated to municipalities (Giraudy 2007). This minimises concerns that spending was used to target municipalities in politically opposed provinces, as was usually the case with other items of discretionary spending (Bonvecchi and Lodola 2010). Unfortunately, data for PIT is only available from 1994. This obviously limits the analysis to the 24 Argentine regions. A second caveat is that the year 1994 may conflate the effects of an approaching election (in 1995).

Table 6.6. PIT jobs and regional characteristics, 1994.

Region	Specialisation	Competitiveness	PIT	Population	Affiliation	Unemployment
CF	0.096	25.65	3.13	9.0	PJ	8.9
B. Aires	0.104	31.93	10.02	38.6	PJ	10.5
Catamarca	0.065	9.18	1.13	0.8	UCR	14.5
Cordoba	0.2	25.4	0.51	8.5	UCR	8.7
Corrientes	0.117	13.18	2.14	2.4	PP	9.6
Chaco	0.289	27.17	2.93	2.6	PP	9.1
Chubut	0.274	11.09	2.33	1.1	UCR	11.7
Entre Rios	0.569	24.37	9.57	3.1	PJ	8.8
Formosa	0.154	13.72	1.48	1.2	PJ	7.3
Jujuy	0.335	16.53	1.12	1.6	PJ	9.1
La Pampa	0.208	14.48	3.84	0.8	PJ	5.5
La Rioja	0.181	15.81	4.96	0.7	PJ	8.5
Mendoza	0.095	15.15	3.41	4.3	PJ	5.5
Misiones	0.206	13.42	2.01	2.4	PJ	
Neuquen	0.035	6.39	3.77	1.2	PP	
Rio Negro	0.305	30.56	8.13	1.5	UCR	
Salta	0.023	7.41	3.2	2.6	PP	
San Juan	0.337	29.56	2.33	1.6	PJ	
San Luis	0.15	13.53	1.38	0.9	PJ	
Santa Cruz	0.539	22.47	1.44	0.5	PJ	
Santa Fe	0.147	24.6	7.08	8.6	PJ	
Santiago Estero	0.105	12.49	6.18	2.1	PJ	
Tucuman	0.446	23.68	16.56	3.5	PP	
T. Fuego	0.53	23.2	0.95	0.2	PJ	

The dependent variable is the percentage of jobs created with the PIT in each region, and is computed over the total amount of PIT-created jobs in 1994. The total is averaged over observations in two points in time, May and November 1994.²²⁸ Such jobs were directly created by government programmes, and exclude employment created as a result of multiplier effects. The measure of regional competitiveness is the same as that used in Chapter 5, and is a weighted measure of regional productivity, where the weight is the regional share of employment. Greater values indicate greater levels of competitiveness. The measure of regional specialisation is also that used in Chapter 5, and is a Herfindahl-Hirschmann Index computed at the regional level for the year 1984.

The analysis includes a measure for the rate of unemployment for the year 1994, available from the Argentine Statistics Bureau.²²⁹ It also includes a dummy variable that sorts regions into affiliated or not, depending on whether the provincial governorship is affiliated to the Peronist Party (value 1) or not (value 0). Finally, the analysis includes a measure of population (% of total). Table 6.6 shows the data used for the analysis.

Data are analysed using OLS with robust standard errors. Consistent with the argument made in Chapter 2, specialised regions should be associated with greater levels of PIT jobs relative to diversified ones.

²²⁸ Data is taken from Golbert and Cetrangolo (1995). It is available from *Revista de Trabajo*, N° 4, Sept/Oct, Buenos Aires, 1994.

²²⁹ Data for two waves, May and October 1994, are averaged.

Table 6.7 Determinants of PIT programmes in Argentine regions, 1994.

	1	2
	PIT jobs	PIT jobs
Regional competitiveness	0.18** (0.07)	0.08 (0.09)
Specialisation	0.31 (0.75)	0.94* (0.56)
Unemployment	-0.29** (0.10)	-0.30** (0.11)
Affiliated	-0.28 (1.62)	-0.49 (1.69)
Population		0.29 (0.18)
Constant	3.38** (1.58)	1.27 (1.84)
Observations	24	24
Adjusted R^2	0.207	0.332

Standard errors in parentheses, * $p < 0.10$, ** $p < 0.05$

Table 6.7 provides the results of the regression analysis. The findings suggest that specialised regions received greater PIT-jobs than non-specialised ones. A first specification in column 1 shows that more competitive regions are associated with a greater proportion of PIT jobs, while regional specialisation seems to not have any effect. The rate of unemployment sheds a negative and significant coefficient. This is in line with a number of studies claiming that unemployment was not a strong determinant of employment programmes (Marshall 1997, Vinocur and Halperin 2004).²³⁰ Political affiliation does not appear to have an effect. This goes against existing research, which finds that partisanship is a strong determinant of the allocation of employment programmes (Giraudy 2007). Column 2 includes a measure of population. The coefficient for regional competitiveness is still positive but loses significance. However, the term for regional specialisation increases in magnitude and becomes significant, indicating that specialised regions are associated with greater shares of PIT jobs than diversified ones. This is consistent with the claim that

²³⁰ However, such studies do not systematically test the different drivers of employment programmes.

policymakers under plurality catered to geographically concentrated regions. It is also consistent with research showing that employment programmes did not entirely respond to clientelistic motives, as pointed out by existing studies (Giraudy 2007, Vinocur and Halperin 2004).²³¹ Over time, the scope of programmes financed by the Fund grew²³² and funds were devoted to fostering employment in different ways.²³³

6.4 Conclusions

This chapter has aimed to clarify the relationship between regional demands, institutional arrangements and the provision of compensation, by exploring policy processes and outcomes in settings with and without strong upper chambers. In the absence of cross-national data on the preferences of regional representatives, the case studies shed light on the mechanisms driving policy outcomes. Consistent with theoretical expectations, policymakers selected under proportional rules in Spain did not benefit concentrated losers from trade. Instead, policy targeted groups of voters that lacked geographical concentration by increasing spending on pensions, education and health, at the expense of active and passive labour market policies.

In Argentina, the presence of a second chamber with legislative authority drove policy outcomes. Regional representatives with a preference for relatively low compensation succeeded in imposing their policy preferences, but those with preferences for high compensation were able to introduce modifications that served their purposes. Moreover,

²³¹ Exploring the distribution of employment programmes by the federal government over the period 1993-2002, Giraudy (2007) finds that in addition to partisanship and provincial overrepresentation, roadblocks were an important determinant of the allocation of employment programmes by the federal government. The findings emphasise that the government also offered programmatic responses to *piqueteros*' demands. The latter were in good part linked to specialized regions.

²³² *Clarín*, "Aceleran los nuevos programas de empleo", May 31, 1995.

²³³ For instance, Law 24467 on Small and Medium Enterprises, sanctioned in March 1995, explicitly stated that redundancy payments as well as training programmes in the event of closure due to productive reconversion (so-called preventive crisis procedure) would be covered by the Fund (Cetrangolo and Golbert 1995).

the analysis of employment programmes emphasises that in the absence of regional veto players, policymakers with incentives to target geographically concentrated interests targeted policy to specialised regions.

Conclusions

What accounts for the different ways in which democratically elected policymakers allocate the costs and benefits of international trade? Why do levels of compensation vary among and within countries, despite similar levels of exposure to trade? Prominent arguments in comparative and international political economy claim that international economic competition increases demand for social protection that compensates individuals for the costs of trade, and governments concerned with political survival are helped (or hindered) in this task by a variety of institutional arrangements. Such models assume that the preferences of those that stand to lose from trade are generally stable, and that institutions channel such preferences to produce policy that benefits trade losers. This research challenges some of these assumptions and provides an account that emphasises the wide economic heterogeneity driving the demand for compensation and its implications for institutional responses.

7.1 Summary of the argument and findings

The research has provided a comparative argument of compensation in open economies that accounts for differences in the degree to which governments protect losers from trade. The starting point of the argument was that not all individuals that face income losses from trade are equally *losing*. Individual interests are shaped by the level of income from trade and by the variability of returns. The extent of uncertainty is contingent on features of the regional environment that ease or hinder mobility across sectors in the event of job loss. This generates varying levels of support for compensation by those who are typically considered trade losers: individuals in

specialized and uncompetitive regions are most exposed to the risk of income loss and thus demand higher levels of compensation, while similar individuals in diversified regions have greater outside options and demand lower levels of policy. Those in competitive regions are least exposed to labour market risk, and the effect of trade on demand among them is minimum.

The argument then claimed that national policymakers in systems governed by majoritarian rules have strong incentives to provide compensation when losers from trade are geographically concentrated. Policymakers under plurality have incentives to target voters in particular districts. In the presence of geographically concentrated high demanders, plurality leads to high compensation relative to proportional systems. In contrast, policymakers under proportional rules have fewer incentives to target particular constituents. Even if trade losers concentrated in uncompetitive regions demand greater spending, catering to such losers is unlikely to increase policymakers' chances of re-election. In turn, the presence of dispersed trade losers dampens differences between electoral rules. Policymakers under plurality have few incentives to target dispersed trade losers, while under PR incentives to target dispersed losers are dampened by lower levels of demand. This implies that electoral institutions only make a difference when trade losers are concentrated.

Finally, the theory extended the argument to those cases where regional interests are represented in the national policymaking process. It emphasized that the presence of a strong upper chamber in bicameral systems generates institutional veto players with incentives to respond to particular interests. The spatial argument has implications for policy within and across countries. Across countries, the presence of an upper house with legislative authority is expected to lead to lower levels of compensation relative to where the former does not exist, for both majoritarian and proportional rules. Within

countries, the presence of a strong upper chamber should dampen levels of compensation when regional veto players in the upper house prefer lower levels of policy, and this reductive effect is expected to be larger at high levels of demand. In bicameral systems with a strong upper house, therefore, electoral rules are expected to make less of a difference.

The research has provided evidence in support of these claims. The analysis of survey data in Chapter 3 tested the micro-foundations of the theory across a sample of regions in Europe, and finds that regional economic specialization and regional competitiveness jointly condition the impact of trade on preferences for compensation. In line with expectations, the analysis shows that support for compensation is highest among losing factors in specialized and uncompetitive regions, and is dampened among similar individuals in diversified regions. At low levels of regional competitiveness, trade losers do not exhibit significant differences in terms of support for compensation. In addition, the greater variability in the estimates of support for compensation in specialized and competitive regions is consistent with the expectation that in such regions, the effects of specialization and competitiveness cancel each other out.

Having established the conditional impact of trade on individual preferences, Chapter 4 then evaluated the macro-level implications of the theoretical model by looking at how institutional arrangements translate preferences into policy. Specifically, it explored the extent to which the geographical concentration of trade losers mediates the effect of electoral and legislative institutions on the generosity of compensation under trade in a panel of European countries over 1980-2010. A first part of the analysis shows that where trade losers are concentrated, governments in systems with lower district magnitude provide greater compensation relative to those in systems with higher magnitude. In contrast, when trade losers are dispersed, the effect of institutions on

compensation is dampened. Both findings are consistent with the theoretical expectations. A second part of the analysis demonstrates that for a given level of demand, the effect of electoral institutions on compensation is conditional on regional influence in the national policymaking process. The findings show that in countries with extensive regional authority, the effect of electoral rules on compensation is dampened. This provides support for the claim that where regions are capable of exerting influence in national policymaking, legislative bargaining between regional veto players and the national government drives policy outcomes. In such situations, electoral rules make less of a difference. Together, the quantitative analyses provide rigorous evidence for several of the theoretical claims developed in Chapter 2.

To complement these results, Chapters 5 and 6 turn to case study analyses of compensation in Spain and Argentina. Chapter 5 relies on a mix of quantitative and qualitative data. Spain and Argentina constitute good candidates for the task: both display significant within-country variation in the geographical distribution of trade losers. In addition, the sub-national focus provides variation and makes it possible to control for country-level characteristics. The analyses of survey data provide evidence for the claim that individuals in specialized and uncompetitive regions support greater levels of compensation than similar individuals in diversified regions. They also suggest that individuals in competitive and specialized regions support relatively lower compensation than similar individuals in diversified regions.

The qualitative comparison illustrates that regional features such as regional competitiveness and specialization jointly mattered in shaping patterns of demand for compensation. Workers in specialised and uncompetitive regions faced very high levels of risk, and the cases of Asturias in Spain and Cordoba in Argentina arguably reflect the high levels of demand generated in the wake of liberalisation. In regions such as the

Basque Country and Mendoza, both uncompetitive but more diversified, trade losers faced lower levels of risk, and accordingly demanded lower compensation. In turn, losing workers in the competitive and diversified regions of Catalonia in Spain and Buenos Aires in Argentina faced very low levels of risk despite suffering income losses. Lastly, the case of Andalusia in Spain shows that trade losers in a competitive and specialised region nonetheless faced some risk, and this was reflected in relatively high levels of demand.

Finally, Chapter 6 shifted the focus to the national level and conducted an in-depth examination of the politics of compensation in Spain and Argentina. The analysis illustrated that in Spain, policymakers elected under proportional electoral rules catered to a broader electorate at the expense of concentrated trade losers. In the absence of regional dynamics, the PSOE increased spending on education and pensions at the expense of active labour market policies and unemployment benefits, and favoured regions less in need of it. Arguably, in a system where maximizing the prospect of re-election induces policymakers to cater to a broader electorate, the government could not afford to target policy to concentrated losers (such as Asturias) at the expense of the rest.

The analysis in Argentina illustrates that the presence of an upper chamber shaped the dynamics of compensation in several ways. The presence of a strong upper chamber dominated by relatively low-demanding regions dampened levels of policy. Consistent with theoretical expectations, regional representatives with a preference for low levels of compensation were able to obtain legislation that favoured their constituents at the expense of those in regions most affected by trade liberalisation. Nonetheless, regional interests with a preference for higher compensation were able to extract policy concessions. In addition, the analysis also illustrated how the politics of compensation play out in the absence of regional dynamics, by exploring the distribution of

employment programmes exempt of legislative oversight by policymakers with strong incentives to target concentrated trade losers. Consistent with expectations, the analysis shows that spending on employment programmes was primarily targeted to specialised regions that were arguably more in need of compensation. This provides evidence in support of the claim that, when unconstrained by regional veto players, policymakers elected under plurality target policy to trade losers that are geographically concentrated.

7.2 Implications of the findings

The above findings are important for a number of reasons. Firstly, they illustrate that regional demands and institutions arrangements drove patterns of compensation despite the presence of alternative factors expected to do so. They are thus a rather tough test for the theoretical claim that regional demand and institutional arrangements may jointly shape compensation. Spain represents a likely case for compensation according to standard views. The presence of social democratic government and proportional rules arguably would have predicted greater levels of social spending (Boix 1998, Huo et al. 2008, Persson and Tabellini 2003). To the extent that unemployment protection and active labour market policies constitute an important segment of social policies, such factors should have translated into greater compensation. Consistent with arguments in political economy, spending on pensions and health, both eminent examples of “broad” transfers, increased (Persson and Tabellini 2000, 2003). Yet Chapter 6 shows that while spending on active labour market policies in Spain increased significantly, spending specifically devoted to vocational training and reemployment decreased, and that on unemployment benefits also decreased. According to other prominent views, the presence of a dualised labour market would have predicted low levels of compensation, as social democratic policymakers target labour market insiders at the expense of outsiders (Rueda 2005). To the extent that policy benefitted broad programmes that did

not specifically target labour market risk, social policy in Spain targeted labour market insiders (Rueda 2007). However, the theoretical argument and empirical analysis also suggest that *dispersed* outsiders may not differ that much from insiders in terms of policy preferences. Once such preferences are taken into account, the picture that emerges from Spain is arguably fully consistent with insider-outsider arguments.

In contrast, Argentina represents a likely case of low compensation. Prominent arguments on market reform in developing countries would predict Argentina's structural dependency on international markets to severely constrain social spending (Wibbels 2006). Echoing dualisation arguments, scholars of Latin American reform processes expect the presence of powerful labour interests with a preference for policies that cater to labour insiders to limit the provision of compensation to outsiders (Etchemendy 2011, Murillo 2001). Yet as shown in Chapter 6, international vulnerability to capital markets did not prevent overall increases in social spending – though not compensation. Moreover, the existence of powerful labour interests did not prevent policymakers from targeting outsiders. On the contrary, Chapter 6 shows that regional legislators with a preference for compensation were, despite opposition from a majority of regions, able to shape policy in a manner consistent with expectations. Further, in the absence of regional pressures, the government was able to target employment programmes to concentrated trade losers.

At the level of demand, recent research argues that the beneficial effects of trade liberalisation on the mass of consumers in Latin American countries dampened popular opposition to reform (Baker 2010). This would suggest that trade liberalisation dampened distributive conflict and through this demand for compensation. Yet Chapter 5 shows that patterns of support for free trade varied widely, and differed according to levels of regional specialisation and competitiveness. Lastly, scholars suggest that the

low levels of compensation in Latin America were driven by powerful tradable sectors with a preference for policies that enhance economic competitiveness at the expense of social security account (Wibbels 2006). Chapter 5, however, suggests that tradables demanded policies that compensated for the costs of liberalisation. That policymakers in neither case benefitted trade losers when prominent explanations predicted they would emphasises the limits of existing accounts. By explicitly engaging with alternative explanations, the within country and cross national analyses also clarify the mechanisms underpinning policy.

Secondly, although the focus is on the specifics of trade liberalization, the insights provided by the research are not exclusive to trade or to market reform policies. The within country case study and the cross-national comparison both show that exchange rate changes and structural reform of the public sector had distributive effects across regions. Thus, the research contributes to the more general question of the conditions under which the geographical distribution of the costs and benefits of policy helps policy change in the context of structural reforms.

The research contributes to the literatures in comparative and international political economy. Firstly, it begins to fill a gap in the literature on demand for social protection under trade. Until recently, very little has been known about individual preferences underpinning compensation – or social policy more generally. Introducing a regional dimension of risk in accounts of demand for compensation provides a more complete picture of individual preferences. Although some workers may be expected to lose from trade to a greater extent than others, there may be mechanisms linked to economic geography that may increase or decrease the risks associated with increased foreign competition. The insights underpinning the research build on a growing body of research that underscores the importance of regional economic heterogeneity in shaping

individual demand for redistribution (Beramendi 2012, Rueda and Stegmüller 2014). By emphasising particular features of regional economies that underpin regional heterogeneity, it contributes to the task of specifying the conditions under which economic context may matter. With respect to the literature on trade and compensation, taking into account geographical context as a source of labour market risk in open economies may further our knowledge of the different ways in which industries are likely to matter. This qualifies arguments that have emphasized the role of occupation at the expense of sector of employment (Rehm 2009) in shaping demand for redistribution. Defined in terms of economic geography, industrial sectors are likely to take on a new role (Barber 2014).

Secondly, the research provides a more complete picture of the factors driving compensation outcomes. The findings uncovered throughout suggest that there is no generalised (positive) relationship between trade openness and compensation. On the demand side, the extent to which international competition shapes support for compensation is likely to depend on outside options, and these may be shaped by a variety of different factors. This research identifies a reduced set of them linked to regional context. However, given the complexity of the endeavour, the gridlock that has characterised debate on the relationship between trade and social spending is not surprising. By unbundling the “ties that bind” trade liberalisation and demand for compensation, this research builds on earlier contributions that have called for conditional explanations (Burgoon 2001, Rickard 2006, Walter 2010). More generally, it echoes research arguing that support for redistribution is prevalent among groups that, on an income basis, are expected to exhibit different redistributive preferences (Rehm 2009, Beramendi 2012, Rueda and Stegmüller 2014). By allowing for a degree of

heterogeneity within and across countries, the research challenges assumptions that all losers from trade demand greater compensation.

Thirdly, the research offers a context-specific argument of social spending under alternative electoral systems. With some exceptions, the theorized relationship between electoral institutions and the composition of public spending overlooks the role of domestic economic structure, implying a constant effect of institutions across countries (Persson and Tabellini 2000, 2003, Milesi-Ferretti et al. 2002). The findings for the sample of European countries over the period 1980-2010 show that there is no such generalised effect of electoral institutions. Rather, they emphasise that the effect of institutions is conditional on the geographical distribution of policy beneficiaries. In fact, under certain conditions, proportional representation may have a reductive effect relative to majoritarian institutions. These insights have benefitted from the contributions of a growing literature in international and comparative political economy that underscores the conditional impact of institutions on trade protection (Rickard 2009, Rickard 2012b, Barber 2014, Goodhart 2014) and redistribution (Rodden 2010, Beramendi 2012). This research follows in the steps of such scholars by extending their insights to the debate on compensation in open economies. By specifying the sources of demand underpinning compensation, it also advances our understanding of the conditions under which electoral rules are likely to matter for those that lose from trade. Relatedly, it specifies *institutional* conditions under which electoral rules are likely to make a difference in the provision of policy. The findings uncovered in Chapter 4 suggest that the effect of electoral rules can be limited in the presence of a strong upper house. When regions have the capacity to influence national policymaking, electoral rules matter less for policy, and outcomes are driven to a greater extent by legislative bargaining. These insights draw on a on a distinguished literature on the role of

bicameral systems for representation (Lijphart 1999, Cameron and McCarty 2004) and the role of political incentives in federations (Beramendi 2012, Wibbels and Rodden 2010). The findings are consistent with much of what we know about the effect of upper chambers. This research contributes to this debate by specifying the conditions under the presence of a second chamber is likely to affect the provision of compensation. In so doing, it brings together demand and supply factors.

Finally, the research underscores the existence of factors driving compensation – and potentially other policies – that are common to developed and developing economies. The literature on compensation under trade in developing countries has tended to emphasise the distinct sources of pressures facing such countries. In particular, motivated by the need to understand the common political economic forces underpinning a region so rich and diverse as Latin America, scholars of the region have focused on those factors that set it apart. In this endeavour, research has emphasised the curse of financial dependence on international markets, the politically disempowered mass of its (low-skilled or informal) workers, or the influence of a powerful business community (specifically in the export or tradable sector) that pulls the levers of policy. These arguments have provided invaluable insights to further our understanding of a region marked by pervasive political and economic inequalities. This research suggests these factors coexist alongside deeper forces. It suggests that fundamental dynamics are in place common to both developed and developing world. Politicians in countries with different levels of development and a different set of economic pressures nonetheless faced similar demands for policy that compensated for the costs of trade.

In sum, this research has developed and tested a theory of compensation under trade that identifies some of the key economic and political conditions under which those that stand to lose from trade are likely to be compensated. The theoretical framework allows

for variation in compensation outcomes within countries over time, and thus helps explain the significant variance in policy outcomes across countries that are exposed to foreign competition. The resulting picture brings together a number of previously isolated insights in the literatures on compensation, institutions and regional economics.

By emphasising the distributive effects of trade across regions, the research also has policy implications. International economic institutions often endorse trade liberalization as a solution to a number of macroeconomic problems and as a means to increase aggregate welfare. In countries with strong regional heterogeneity, however, this may have distinct social consequences.

7.3 Future research

The findings uncovered in this research suggest a number of avenues for future research. The first concerns the demand side of compensation, and specifically, the structure of preferences characterising those that stand to win from trade. The micro-level findings in Chapter 3 emphasise that those that stand to lose from greater trade are driven by disparate concerns that – so the argument has claimed – mainly relate to risk. This is a theoretical challenge that has found little echo in the literature on compensation to date. Yet there is ample reason to believe that winners may care about geographical risk too. Recent research in the literature on redistribution argues that both income and risk considerations matter in shaping the extent of redistribution, for both rich and poor (Beramendi 2012), and this is driven by differences in economic geography. In turn, other scholars find wide variation in the redistributive preferences of the rich (Rueda and Stegmüller 2014).

Relatedly, the findings uncovered in Chapters 3 and 5 highlight that individuals exposed to import competition in competitive (and particularly specialized) settings demand less

compensation than theoretically expected, and this suggests that there may be conditions under which ex-ante trade losers effectively *behave* more like winners. This research has aimed to provide a characterization of winners and losers that places them along a continuum, rather than in relatively exclusive categories. The extent to which trade affects individual welfare is a matter of degree. Future research should further aim to go beyond a dichotomous conception of winners and losers.

Finally, developing countries provide exciting opportunities to explore such issues. Extending frameworks that take into account changing economic geographies to such diverse and rapidly changing contexts can bear fruitful insights. Particularly for Latin America, where the availability of data makes comparative analysis possible.

This may help us understand why, despite its stark distributional consequences, rapidly growing trade has not been fundamentally reversed or been met with the popular or political backlash that observers of such phenomena predicted it would.

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