The Politics and Economics of Corporate Subsidies in the 21st Century

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Abstract

Scholars often focus on economic competition between the states as the primary determinant of economic development policies, including direct subsidy spending. New data from the Good Jobs First Subsidy Tracker shows that there are large differences in subsidy spending across the states and that large, established firms are the disproportionate beneficiaries of subsidy spending. In light of this new evidence, we argue that the political power of business within the state is an important determinant of state economic development policy. Campaign contributions from industry serve to create a political presence that reinforces their structural power and has the potential to capture state governments. We theorize that states may be strictly captured or culturally captured, in which the state acts to protect business without being intentionally corrupted by business. We test our hypotheses using data from the Good Jobs First Subsidy Tracker database, finding that more contributions from business lead to more subsidy spending by the state. We conclude that subsidies are the result of the confluence of politics and economics, warranting more attention by scholars because of the practical policy and theoretical implications.

Introduction

Texas Governor Rick Perry irked his fellow governors as he courted businesses across the country to relocate to Texas in the summer of 2013 (Fernandez 2013). His tour was backed by the $200,000 TexasOne offered in advertising. TexasOne is a public-private partnership whose goal is to market Texas as a business-friendly state (McLaughlin 2013). Despite being accused of job poaching, Perry's pitch is indicative of the ongoing competition among states over economic resources and the growing closeness between business and states in creating economic development policies.

A rich body of scholarship has focused on the existence and evolution of interstate competition over economic resources (Eisinger 1988; Berry and Berry 1990; Brace 1993; Cobb 1993; Hanson 1993). Scholars have traditionally treated states as natural competitors locked in an arms race (Peterson 1995). However, states differ substantially in the resources they devote to economic development. In particular, spending on corporate subsidies meant to attract and grow capital investment varies greatly across the states. This paper seeks to answer why.

Building on capture theory, we argue that business contributions influence state spending on economic development. Primarily, we find evidence that the more business contributes to state candidates, the more the state spends on subsidies. This is so because contributions from business are an important signal of the structural power of business in the state political economy and therefore a significant predictor of how much a state grants in subsidies. We demonstrate that it is not the inherent advantages of business but their political presence in a state that determines their ability to extract collective resources for private use. Our finding breaks from the interstate competition model in that state spending is dependent on internal pressure from the state business community, all else equal.

We test our theory by taking advantage of a new, large, and publicly available data source on corporate subsidies at the state level. The non-profit, non-partisan group Good Jobs First (GJF) maintains a Subsidy Tracker database that brings together public records of individual subsidies granted to businesses under a wide variety of state programs. This data includes the actual dollar value of each subsidy, allowing us to measure state economic development spending in a manner previously elusive to scholars. Previous studies of economic development in the states have been limited to measuring economic development in terms of policy indices (Gray and Lowery 1990; Jenkins, Leicht, and Wendt 2006; Saiz and Clarke

2013) or budget spending (Eisinger 1995; Hanley and Douglass 2014) which focuses only on the "tip of the iceberg" by ignoring lost revenue (Bradshaw and Blakely 1999). From 2006-2013, the Good Jobs First Subsidy Tracker identifies roughly $12 billion per year in direct subsidies from state governments to businesses, much of it tax credits and rebates not accounted for in state budget data.

The paper proceeds by first exploring the GJF Subsidy Tracker data in evaluation of the economic development literature. Next, we review the literature on regulatory capture and adapt it for the case of state economic development, using the literature to inform our predictions about the political basis of business influence on subsidy spending. Finally, we conclude with a discussion of further work to be done in exploring this critically important domain of politics and policy.

Business, States, and Economic Development

The literature on state-level economic development policy is grounded in the notion that states compete with one another over economic resources. States compete with one another in order to avoid the loss of population and resources vital to their well-being (Berry and Berry 1990; Baybeck, Berry, and Siegel 2011) as well as to gain economically over peer states (Eisinger 1988; Cobb 1993). To keep pace, states are eager to copy the innovations that increase their appeal to desirable citizens and businesses. Berry and Berry (1990) find that states with the lottery draw revenue away from non-lottery states, forcing neighbors of the lottery state to also adopt the lottery. Florida's (2005) influential work on economic competition shows that states and localities thrive when they pursue economic policies that explicitly appeal to the "the creative class"–a group of young, talented, and innovative individuals. States also tend to adopt policies that decrease their labor costs (Cobb 1993; Hansen 2001; Jenkins, Leicht, and Wendt 2006). The competition stems from the natural imperative of subnational governments to pursue policies that increase their fitness in competition with other subnational governments (Peterson 1981; 1995).

States engage in economic development as a result of economic competition. Economic development policy comes in many forms and has evolved over time in response to the changing economics and politics between the states. Scholars identified three "waves" of development, each of which resulted in new policy tools for states to use in growing their economy. The first wave of economic development is characterized by states incentivizing large manufacturing firms to locate operations within their state. Often referred to as "smokestack chasing" or locational strategies, first wave policies include subsidized loans, relocation

payments and tax reduction as a means of attracting industry to the state (Eisinger 1995; Bradshaw and Blakely 1999; Saiz and Clarke 2013). Although pursued by states since colonial times (Hanson 1990), locational strategies reached their peak post-World War II (Cobb 1993). The second wave of economic development is characterized by states growing and retaining firms and industries within their own borders. Second wave policies are often referred to as entrepreneurial strategies, which involve providing direct subsidies to start ups and new industries and designating areas of the state as incubators or economic development zones (Eisinger 1988; Bradshaw and Blakely 1999; Saiz and Clarke 2013). Second wave entrepreneurial strategies achieved wide-spread use in the 1970s and 1980s (Eisinger 1988, 1995; Cobb 1993).

A third wave of economic development began in the 1990s and continues today. The third wave emphasizes loosening the restrictions on economic innovation and coordinating economic planning between the state and industry (Eisinger 1995). States have begun taking the same global outlook on competition and development as large firms (Bradshaw and Blakely 1999) while pursuing a mix of policies developed in the first and second wave (Hanley and Douglass 2014). The line between first, second, and third wave economic development strategies is not so easily drawn since the rise of the third wave. Take Michigan for example. Michigan recently committed substantial resources to developing a home-grown film industry (Story 2012), while also pursuing property tax breaks that would benefit heavy industry (Eggert 2014) and granting $175 million to subsidize Ford Motor Company's retrofitting of an assembly plant in Wayne County (GJF 2013). All of these were part of a state-wide attempt to revitalize cities devastated by de-industrialization (Story 2012). Michigan is using strategies popularized in each of the three waves of economic development. The main difference between the third wave and previous waves is the growing coordination between industry and the state.

Scholars such as Charles Lindblom have argued that business holds a "privileged position" in American society and politics (1977, 1982), and it appears as though the relationship between business and state government is growing closer still in the realm of economic development. The economic market places constraints on democratic government, giving business privilege or "structural power" helping protect business economic interests through policy (Peterson 1981; Lindblom 1982; Pontusson 2011), especially when it has the support of the public (Smith 2000). The growing closeness between states and industry has led some scholars to comment that state economic development is looking "very much like the industrial

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strategies of the largest global firms as they position themselves for global competition"(Bradshaw and Blakely 1999). Businesses seek partners in states, and states seek partners in businesses but the partnership could be evolving to a business-dominant relationship as the cost per job for states grows (Eisinger 1995; Hanley and Douglass 2014). In 2011, tax credits claimed by film companies cost North Carolina $30 million, but resulted in only 55-70 jobs–about $500,000 per job (Curliss 2013). Just two decades ago, Alabama was criticized for paying $168,000 per job in its incentive package to BMW (Teitz 1994). Whether states have begun to act on behalf of industry in formulating economic development policy is a question that remains unanswered by the literature.

Subsidy Spending in the States

We can begin to explore the relationship between business and state governments by looking at the distribution of state economic development spending. The current literature on economic development holds three predictions that can be tested using data from the Good Jobs First Subsidy Tracker database. First, there should be a steady increase in the economic development activity of states as they aim to match or better their competition. Second, there should be a mix of locational and entrepreneurial strategies pursued by states, holding with the scholarly description of the current third wave economic policy. Third, we should find that larger firms receive the majority of state subsidies as competition continues to increase and business helps define state economic development strategy.

Figure 1 depicts the increase in both the total number of subsidies and the number of subsidies worth over $75 million granted to businesses by states from 2000-2012 (GJF 2013). The first time series (in gray with square points) is a count of the number of subsidies given to businesses by all states for each year since 2000. There was steady growth in the number of subsidies, increasing from 1,982 in 2000 to 48,224 in 2012. The number jumped to over 20,000 in 2002 and never returned below 6,000. The number of subsidies worth over $75 million, designated "megadeals" by Good Jobs First, has steadily grown as well. The megadeals time series (in black with circular points) is also displayed in Figure 1. Nine megadeals were entered into by states in 2000, growing to 21 in the year 2012. There was an average of 13 megadeals per year from 2000 to 2012, with a high of 28 in 2009. States plateaued in their megadeals at the tail-end of the series, perhaps reflecting strained state budgets during the Great Recession; in contrast, the number of subsidies skyrocketed. The data tends to support the prediction that states are increasing their involvement

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Figure 1: Growth in Subsidies to Business, 2000-2012

Source: Calculated by authors using Good Jobs First Subsidy Tracker data

in economic development.

The second prediction is that states use a mixture of entrepreneurial and locational strategies in growing, supporting, and attracting industry in the state. While the GJF data is not explicitly coded into entrepreneurial or locational strategies, we can get a sense of the distribution of corporate subsidies across these strategies by looking at simple descriptive statistics. If entrepreneurial strategies dominate, the data should be skewed left, with the vast majority of observations being small tax rebates and grants. If locational dominates, the opposite should be true. Table 1 presents descriptive statistics calculated using the GJF data. What we observe is that the vast majority of subsidies to businesses are small. There were 127,575 individual subsidies from 2006-2013 (GJF 2013), with the average subsidy value being $838,433, far below the largest subsidy, an $8.7 billion dollar package offered to Boeing by the state of Washington. The median is $23,000 and the tenth percentile value ($476,125) falls far below the average value, indicating significant left skewness in the distribution.

The vast majority of subsidies offered and granted are small and available to all businesses. But large

Table 1: Descriptive Statistics of Good Jobs First Data, 2006-2013

Min	$1
Max	$8.7 B
Mean	$838,433
Median	$23,000
SD	$30,573,926
Top 5%	$1,093,162
Top 10 %	$476,125
N	127,575

Figure 2: State Economic Development Spending and Activity by Type of Subsidy, 2006-2013
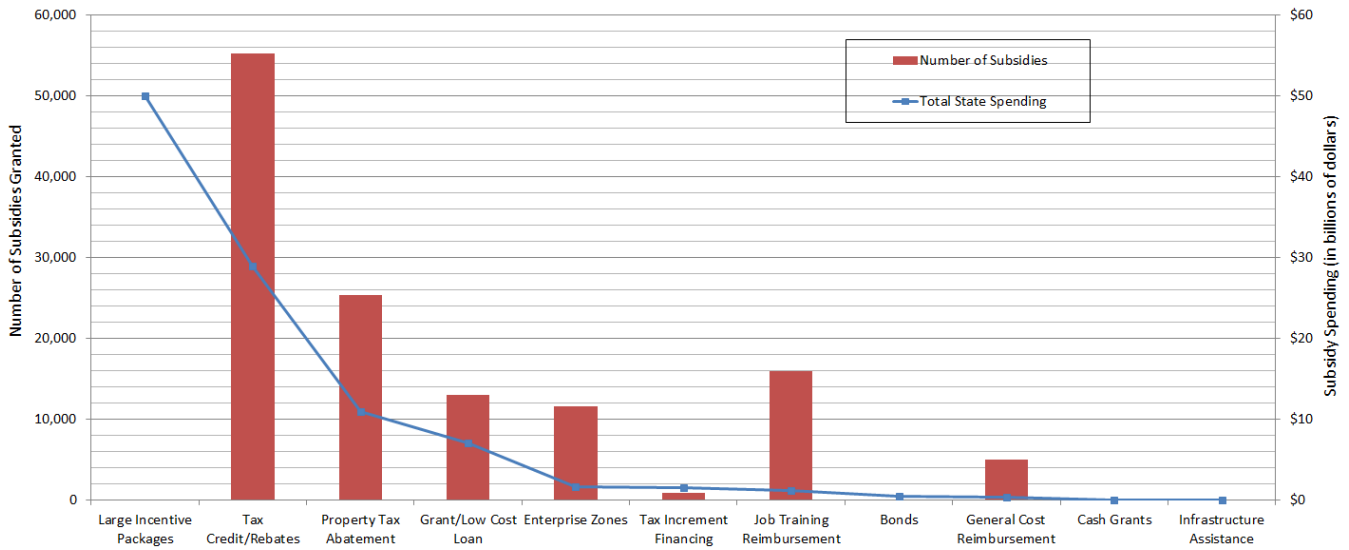
Source: Calculated by authors using Good Jobs First Subsidy Tracker data

subsidy packages meant to incentivize businesses to locate operations in a particular state make up the vast majority of spending. Figure 2 breaks down the number of subsidies and subsidy spending by type. The types, coded by Good Jobs First, are large incentive packages, tax credits/rebates, property tax abatement, grant/low cost loan, enterprise zones, tax increment financing, job training reimbursement, bonds, general cost reimbursement, cash grants, and infrastructure assistance. The types of subsidies represent policies popularized in all three waves of economic development. Looking first at the number of subsidies granted by states to businesses from 2006-2013 (the red bars), we see that the type of subsidy most often used by states are tax credits and rebates. From 2006-2013, there were over 55,000 tax credits or rebates awarded by states to businesses through a variety of economic development programs. This accounts for 43% of all subsidies. The second most used type of subsidy is property tax abatement. This finding fits with the literature in that state governments tend to prefer to use non-budgetary means and short-term means of

growing the economy (Buss 2001; Dewar 1998). The states also use a fair amount of grants/low cost loans, spending on enterprise zones, and reimbursement to businesses for job training costs. Rarely used are tax increment financing deals, bonds, cash grants, and infrastructure assistance–subsidies that are likely to run into greater political hurdles in the budgetary and regulatory process. Despite the headlines, less than 1% of subsidies are large incentive package.

Large incentive packages, however, account for the vast majority of state subsidy spending. The states collectively spent nearly $50 billion on large incentive packages, or 48.8% of the total spending over the eight year period. The next highest was spending on tax credits and rebates at just under $29 billion. The distribution of spending tails off quickly, with bonds, general cost reimbursement, cash grants and infrastructure assistance accounting for less than 1% of all state subsidy spending. The data shows that characterizations of state economic development are dependent on the metric the researcher chooses. When looking at the number of subsidies by type, states are most active in using the tax code to facilitate and encourage economic growth. This fits closer with the entrepreneurial strategies developed in the second wave and continued in the third wave. When looking at amount of spending by type, states spend the most money on large incentive packages meant to attract, retain, and aid industry. By the spending metric, locational strategies dominate.

In evaluating the prediction that large firms and states are working more closely than before, we take a closer look at the firms that receive the most subsidy dollars. Table 2 documents the top 50 recipients of subsidies from state governments from 2006-2013 using the GJF Subsidy Tracker data. While the "chip chasing" and "film chasing" strategies of states have garnered much attention, the largest recipients of subsidies remains manufacturers of durable goods.[1] Five of the top ten recipients are durable goods manufacturing firms (three automobile [GM, Ford, Chrysler], one aerospace [Boeing] and one aluminum [Alcoa]), as are 20 of the top 50. Non-durable manufacturing such as chemicals and natural resource refinement accounts for an additional three of the top ten (Cheniere [Natural Gas], Royal Dutch Shell [Oil and Gas], and Dow [Chemical]) and eight of the top 50. The largest non-manufacturing recipient is Nike, a primarily retail firm.[2] Fully, six automobile manufacturers make up the top 50. Casting a wide net, there are several firms that could fall under the broad category of information, arts, and entertainment–Cerner,

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[1]Classification based on U.S. Bureau of Economic Analysis categories

[2]While Nike manufactures shoes, they do so almost entirely overseas. The subsidy package being granted from Oregon is to retain its headquarters, where design, management, and marketing take place

Table 2: Top 50 Recipients of Corporate Subsidies from State Governments, 2006-2013

Rank	Company	Total Subsidies (2006-2013)	Rank	Company	Total Subsidies (2006-2013)
1	Boeing[†]	$9.757 B	26	Michelin[†]	$328 mil
2	Alcoa[†]	$5.609 B	27	Spirit AeroSystems[†]	$314 mil
3	General Motors[†]	$3.939 B	28	International Sematech[★]	$305 mil
4	Cheniere Energy[★]	$3.441 B	29	Nucor[†]	$301 mil
5	Ford Motor[†]	$2.984 B	30	Orca Bay Seafoods[*]	$296 mil
6	Nike[○]	$2.021 B	31	Amazon.com[○]	$292 mil
7	Royal Dutch Shell[★]	$1.794 B	32	Areva[★]	$292 mil
8	Chrysler[†]	$1.742 B	33	Sasol[★]	$279 mil
9	Cerner[●]	$1.725 B	34	Electrolux[†]	$278 mil
10	Dow[★]	$1.377 B	35	Sears[○]	$275 mil
11	Advanced Micro Devices[†]	$1.201 B	36	Google[●]	$268 mil
12	ThyssenKrupp[†]	$1.103 B	37	Yahoo[●]	$260 mil
13	Toyota[†]	$929 mil	38	Orascom Construction[∓]	$251 mil
14	Nebraska Furniture Mart[○]	$802 mil	39	Kentucky Syngas[★]	$250 mil
15	Shintech[†]	$735 mil	40	Triple Five[⊙]	$250 mil
16	Revel Entertainment[◁]	$584 mil	41	Wacker Chemical[★]	$234 mil
17	Motiva[★]	$562 mil	42	Viridia[⊕]	$230 mil
18	Volkswagen[†]	$557 mil	43	Prudential[⊙]	$224 mil
19	Clean Coal Power Operations[★]	$550 mil	44	Duke Energy[◇]	$216 mil
20	Forest City Enterprises[♭]	$521 mil	45	Valero[★]	$215 mil
21	General Electric[†]	$476 mil	46	Huntington Ingalls[†]	$214 mil
22	Samsung[†]	$446 mil	47	Morgan Stanley Group[⊙]	$213 mil
23	Apple[●]	$446 mil	48	Baxter International[♯]	$211 mil
24	Hyundai-Kia[†]	$414 mil	49	LG-Chemical[†]	$198 mil
25	IBM[●]	$358 mil	50	Weyerhaeuser[†]	$196 mil

† Durables Manufacturing ★ Non-durables Manufacturing ● Information ♯ Health care ⊙ Finance ♭ Real Estate ◇ Utilities ⊕ Waste Management ◁ Arts Production ○ Retail ∓ Construction * Food Production
Source: Calculated by authors using Good Jobs First Subsidy Tracker data.

Revel, Apple, IBM, Amazon, Google, Yahoo, and Samsung. The net could be cast further to include the waste management firm Viridia, and innovative energy firms Clean Coal Power and Kentucky Syngas, but the vast majority remain manufacturers. Furthermore, 30 of the 50 are Fortune 500 or Fortune Global 500 firms indicating their status as large established firms.[3] From this data, we see that states are using large incentive packages in a venture capital capacity as well as a locational capacity. While there is a mix between established and newer firms, and a mix of industries, the majority of the largest recipients are established manufacturing firms. We also see great inequality among businesses that receive state subsidies; the top 50 recipients represent less than 1% of all firms receiving subsidies but account for

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[3]The number grows to 31 if you count Nebraska Furniture Mart, a subsidiary of Berkshire Hathaway

45.9% of all subsidy spending.

The GJF data supports major predictions made in the economic development literature; there has been steady growth in economic development activity and spending overall and the majority of economic development activity by states is entrepreneurial economic development. However, the majority of spending is in large incentive packages that benefit single firms. Major recipients are dominated by established manufacturers, despite claims that information technology and the arts are in vogue. The growing closeness between states and business appears to be a growing closeness between states and established large firms.

Capture Theory and Economic Development Policy

While there is growth in overall activity and spending, there is great variation in individual state spending and disparities in the recipients of state spending. The answer to this puzzle lies in the internal politics of the state. While economic competition characterizes the external dynamics in which a state makes economic decisions, those decisions are filtered through the domestic politics of the state. In particular, the political power of business differs across the states, leading to differences in state spending and the privilege of certain firms over others.

Capture theory is a model of understanding influence in the policy making process and we adapt it here for the case of economic development policy in the states in order to explain differences across the states and the privilege of some firms over others. Capture occurs when firms effectively seize control of a government body and use it to their advantage. While the original scholars of capture (Huntington 1952; Bernstein 1955; Stigler 1971) worried about the ability of a single firm or industry to capture a single regulatory agency, more recently, scholars have worried about the ability of industry to capture government as a whole (Lindblom 1977; Peterson 1981; Posner 2014; Carpenter and Moss 2014). Furthermore, capture has been traditionally thought of as occurring in regulation, but classic policy theorists Lowi (1972) and Wilson (1973) would disagree. State economic development policy falls under the broader category of distributive policy (Lowi 1972) because it involves the use of collective resources to benefit the relative few. Lowi theorizes that distributive policies are formulated primarily by policy subsystems. That is, distributive policies are dominated by the vested interest groups and relevant legislators and regulators. Similarly, economic development would fall under client politics in Wilson's (1973) typology, where costs are diffuse and benefits concentrated. In later work, Wilson (1989) explains that client politics creates a

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high risk of capture unless the power of industry is balanced by a variety of groups (see also Sabatier 1975; Gormley 1982; Berry 1984; Rourke 1991; Schwarcz 2014). These classic theories point to the importance of interests in determining subsidies. In fact, while regulation weakening came to characterize many of the studies of capture, rent-seeking is the more general and traditional domain of capture (Carpenter and Moss 2014).

There are a variety of types of capture. Capture in its strongest form is when government violates the public interest in the pursuit of private desires to the extent that the public would be better off without the government or subgovernment. In a weaker form, capture compromises the capacity of a government or subgovernment to act in the public interest. In a special project on preventing regulatory capture, political scientists collectively formulated three criteria for detecting capture: 1) the public interest must be defined, 2) there must be intent by the regulated or rent-seeking industry, and 3) there must be a shift in policy away from the public interest and toward the industry interest (Carpenter and Moss 2014). Without meeting these criteria, industry can still be influential (Yackee and Yackee 2006; Gordon and Hafer 2005, 2007), but cannot be said to have captured the policy process (Yackee 2014).

Some scholars have relaxed the condition of intent by the regulated industry in order for there to be capture of government by business. This is a case of capture called cultural capture (Kwak 2014). Cultural capture is when regulators or legislators make decisions on behalf of business because their conception of the public interest is defined by business. In other words, government can be effectively captured without business making a concerted effort to capture. Instead, an interest can be so successful in defining the public interest in its favor that government acts on behalf of business without business directing government action. A policy domain can be effectively captured without exchange of money explicitly meant to buy control in a government or sub-government.

Campaign contributions made by business to state candidates can enhance the presence of business in a state without campaign dollars serving as an exchange for subsidy. In fact, numerous scholars have identified campaign contributions as being associated with motivating costly legislative behavior, signaling interest in a particular policy or regulation, or buying access to legislators (e.g. Hall and Wayman 1990; Hall and Miler 2008). All of these fall short of traditional rent-seeking or corrosive capture, where money is exchanged for power. Instead, contributions are made to build, protect, and reinforce a policy, making it more entrenched and central to defining a policy as being in the public interest. Furthermore, lawmakers

have a rational incentive to seek investment both in the economy and in their campaign war chests as a means of pursuing re-election and good public policy (Fenno 1973).

In sum, the literature on capture and influence in policy making informs us that state governments can be effectively captured without a concerted effort by a firm, industry, or business to capture government. Instead, they can be so influential in defining corporate subsidies as a necessary function of government that government works to protect business despite public sentiment against subsidies.

Theoretical Framework for Capture in the American States

Business is active in politics to 1) protect itself against government action and 2) obtain private benefits from collective resources. Since we are focusing on distributive subsidies, our discussion will center on the latter. Because of the competitive environment in which business operates, they seek benefits from government in order to supplement their fitness in the market. Businesses justify the pursuit of private goods from government by framing it in terms of the public interest. This is sometimes relatively uncontroversial, such as public backing of private accounts at private banks through the Federal Deposit Insurance Corporation (FDIC); without the public guarantee, bank runs would occur on market downturns and the poor and rich would suffer. Other times, it is highly contentious, such as the government's role in providing bailout funds to auto and financial industry giants during the Great Recession. The bailouts were argued as being in the public interest; without them, millions of jobs would have been lost and there was a high probability of another great depression. Yet, the benefits went directly to the corporations seen as culpable for the problem and did not include similar funds for millions of foreclosed homeowners.

Government intervention in the marketplace through subsidies to business is not automatic; businesses must be active participants in the political process. Business is involved in lobbying more than any other interest sector, active from the formulation of policy ideas to the bureaucratic implementation of laws. The lobbying efforts of business are supplemented by campaign contributions. Businesses use campaign contributions in a variety of ways, such as buying access to legislators, subsidizing legislative efforts such as bill sponsorship, log-rolling, and bureaucratic oversight. Most important for this study is that campaign contributions are used to build reputation and signal particular policy interests. Repeated and increased contributions create a reputation for being an important political player with policy interests, existence of powerful allies, and a willingness to fight. This creates a political culture in which business is highly

valued and whose courtship is instrumental in winning elections and growing the economy.

Not all businesses are created equal in politics. Businesses with more resources can more easily build a reputation by making campaign contributions. The result is a larger political presence that can be used to their advantage in policy. Using this reputation or presence, large businesses are most likely to reap large subsidies from states. By using their economic strength to signal political strength, large firms are able to ward off political challenges. With other states ready to gain political and economic allies, states are compelled to respond to firms with a large economic and political presence with favorable incentives.

However, we know from our analysis so far that states provide many small subsidies to small businesses. A small start-up firm may benefit from existing policies but is unlikely to have been instrumental in policy formulation, implementation, and funding. Yet it still begs the question of whether large firms are capturing states to benefit only themselves or to benefit the business as a whole. The distinction between strict and cultural capture becomes important here. If states are being strictly captured by large firms, then we should observe a direct relationship between the political presence of business (measured in campaign contributions) and the cost per subsidy in a state. States with higher subsidy values or costs are awarding either fewer or more valuable subsidies than other states. This is an indicator that states are targeting subsidies to particular firms or industries or awarding certain firms disproportionately to others. This leads to our strict capture hypothesis, stated clearly below.

Strict Capture Hypothesis: States increase spending per subsidy the more state candidates receive in campaign contributions from business.

If states are not being strictly captured by business, but instead being culturally captured, we should observe contributions resulting simply in higher subsidy spending. With cultural capture, the political and economic power of business helps define the political conversation in a manner favorable to business and not a particular firm. State decision makers begin to see the world the same way business leaders and entrepreneurs do due to a close political, social, and economic relationship. As a result, states enact policies to become more business friendly, rather than just friendly to certain businesses. In states with a large business political presence, this effect will be more pronounced than that in states where business has not cultivated a political presence despite economic competition also driving spending. Furthermore, while contributions may be made by only a few firms or industries in the state, the rising tide of political power raises all of business' boats. While each business benefits some, the largest and most active firms

certainly benefit the most, as they receive subsidies several orders of magnitude larger than small and medium sized businesses. Nonetheless, subsidy spending in states that are culturally captured by business will be much higher than in other states, all else equal. This leads to our cultural capture hypothesis, stated clearly below.

Cultural Capture Hypothesis: States increase total subsidy spending the more state candidates receive in campaign contributions from business.

Methodology for Testing Capture Hypotheses

To test the strict and cultural capture hypotheses, we use data on state-level spending from the Good Jobs First database. To test the strict capture hypothesis, we created the variable *Average Subsidy Value*, which is the average subsidy by dollar amount awarded to businesses by each state in each year. We downloaded the cumulative file from GJF, in which each observation is a subsidy granted by a state to an individual firm. We excluded the observations that fell outside the time range, excluded any observations that did not provide a value for the subsidy granted, and then aggregated the subsidy values by state-year and divided by the number of subsidies granted in that year. The variable was standardized by taking the natural log because there was variance of several orders of magnitude between some states (spending millions versus spending billions). Unequal variance could cause inefficiency in estimation if not logged. To test the cultural capture hypothesis, we created the variable *Total Subsidy Spending*, which is the total dollars awarded to businesses by each state in each year. Again, we took logged the variable in order to deal with unequal variance between states.

Each observation of both dependent variables is a spending by state-year (for example, Illinois 2008), making the data time-series cross-sectional. The years range from 2006-2012 and there are 46 states represented in the data. There is no data available for Hawaii or Wyoming in the GJF data. Nebraska is excluded because of its non-partisan legislature because we include party control of the legislature as an independent variable in the model. Alaska is excluded because the subsidy spending of its neighbors could not be calculated due to its geographic isolation and we include neighbor subsidy spending as an independent variable in the model. Data is not present for each state for each year, but most states are present in the data for each of the seven years. The total number of observations, therefore, is 286.

Our independent variable of interest is total contributions from business to state candidates for each

state-year. We logged this variable as well because of unequal variance between states (thousands to tens of millions). We expect a positive relationship between the variable and each of the dependent variables, based on the strict and cultural capture hypotheses. The data for the variable is obtained from the National Institute on Money in State Politics, a non-partisan institute that maintains the *Follow The Money* database of state-level campaign finance disclosures (National Institute on Money in State Politics 2014). The Institute codes each donation into an "economic interest;" we compiled all contributions from Agriculture, Construction, Miscellaneous Communications, Printing and Publishing, TV and Movie Production, Telecom Services, Equipment, and Utilities, Electronics Manufacturing, Computer Services, Defense, Energy and Natural Resources, Finance, Insurance and Real Estate, General Business, Health, and Transportation interests to create a sum total of contributions by business interests to state candidates. The variable is a rolling sum of contributions from the current and previous year because of the U.S.'s two-year election cycles. For example, observation Illinois 2008 consists of business contributions from 2007 and 2008.

Also included as an independent variable is the subsidy spending of neighbor states. In the strict capture model, neighbor subsidy spending is the average subsidy by dollar amount across all neighbor states for the given year. In the cultural capture model, neighbor subsidy spending is the total dollars spent across all neighbors for the given year. Each of these variables is logged. Consistent with the economic development theory's grounding in economic competition, we expect greater subsidy spending by neighbors to result in greater economic development subsidy spending by states, all else equal.

We include a number of economic variables in the model to test whether the amount a state spends on subsidies is also influenced by the economic climate of the state. First, we include the unemployment rate for each state-year. The unemployment rate data varies across states and time and was obtained from the U.S. Bureau of Labor Statistics (BLS 2013). Since subsidies are seen as a way to develop the economy by supporting businesses that create jobs, states should increase subsidy spending in years of higher unemployment. Thus, we expect the unemployment rate to be positively related to subsidy spending, all else equal. Second, we include the percent change in manufacturing gross state product (GSP) from the previous year for each state-year. This is a measure of volatility in the state's manufacturing market. We chose manufacturing because the descriptive data suggests subsidy spending is dominated by large manufacturing firms (see Table 2). States with larger swings may need to use subsidies to stabilize and grow their manufacturing base, creating stable and high-quality jobs. There was a relatively high amount of

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volatility in manufacturing GSP in the period studied, with the largest gain being a 48% increase in manufacturing GSP and the largest loss a -25% decrease from one year to the next. Data on manufacturing GSP was obtained from the U.S. Bureau of Economic Analysis (BEA 2014). We expect there to be a negative relationship between percent change in manufacturing GSP and subsidies. When manufacturing is booming, states can ease subsidization of the industry, but they must increase subsidies when losses are imminent.

We also included a state government party control variable for each state-year. The variable is coded 1 if the state government is unified Democratic, 0 if the state is unified Republican, and 0.5 if either the governor's mansion, state house, or state senate is controlled by one party and the other institutions by another party. Generally, Republicans are seen as more pro-business and may spend tax dollars in support of business, despite also being fiscally conservative. Many on the right, especially the Tea Party, decry subsidies as "corporate cronyism". But supporters of subsidies are generally large business associations, such as U.S. and local chambers of commerce, manufacturers associations, and the Business Roundtable, which are closely allied with establishment Republicans. Democratic intervention in the marketplace tends to take the form as labor market reform and subsidies to individuals rather than benefits for businesses. Thus, we expect a negative relationship between this variable and the dependent variable; united Democratic governments should award fewer subsidies.

Finally, we included two regional indicator variables. The first is an indicator for southern states. The second is an indicator for rust belt states. These indicators are important to include because it helps to model the historical roles of states in economic development. The south has used large subsidy packages to attract business and close the gap between them and northern states, especially since World War II (Cobb 1993; Cummings 1998). The south is defined as Kentucky, Tennessee, Virginia, South Carolina, North Carolina, Georgia, Florida, Alabama, Mississippi, Arkansas, and Louisiana. The rust belt, once the world-leader in manufacturing goods, has seen a sharp decline in manufacturing since the 1970s as a result of accelerated globalization. The de-industrialization of some northern states has led them to offer large incentive packages to deter manufactures from leaving and to attract global firms to their skilled workforce. The rust belt is defined as Massachussetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Ohio, Indiana, Illinois, Michigan, and Wisconsin. These states have seen the largest drops in manufacturing GSP over the past four decades.

The model is estimated as a random effects model using generalized least squares estimation. The random effects model is a preferred model for time-series cross-sectional data as it produces unbiased and efficient estimates assuming the structural portion of the model is correctly specified. In this context, it is the preferred model over a fixed effects (or least squares dummy variable) model because the fixed effects model, while also producing unbiased estimates for time-series cross-sectional data, models the idiosyncracies of each unit by including a dummy variable for each state. However, this approach does not provide an explanation as to why states differ. Our research question asks why states differ in their subsidy spending and our independent variables attempt to model important differences between the states. The random effects model controls for unit effects in order to avoid parameter bias, but does not estimate specific unit effects. This approach assumes the structural portion of the model is correct and leaves the idiosyncratic or path-dependent variance between the states unmodeled, an approach that gives us the most leverage on our research question.

Results and Discussion

The results of our model are presented in table 3. We find strong support for the cultural capture hypothesis but fail to reject the null hypothesis in the case of strict capture.

Looking first at the strict capture model (model 1), business contributions were estimated to have a positive impact on the value of the average subsidy offered by states. However, the point estimate was not statistically significant; we cannot reject the possibility that the positive effect could be due simply to chance. Three of the independent variables were found to be statistically significant predictors of the size of subsidies offered by states. States with neighbors that had large sized subsidies, southern states, and rust belt states had larger subsidy sizes than other states, all else equal. Taken together, this is substantial evidence in support of economic competition theory. States whose neighbors' subsidies are high in value are likely to match their neighbors' spending with high value subsidies. Southern states, historically seen as economic laggards compared to the industrialized north, are also more likely to offer high value subsidies in order to attract and grow industry all else equal. Similarly, the rusting northern states under threat of losing additional businesses to the south are more likely to offer high value subsidies all else equal. The model shows that competition is between state neighbors and regions of the United States, resulting in larger subsidies on average. The unemployment rate, Democratic party control, and percent

Table 3: Estimation of Strict and Cultural Capture Models of State Subsidy Spending

	Model 1 Average Subsidy Value	Model 2 Total Subsidy Spending
Business Contributions	0.202	0.361**
	(0.121)	(0.002)
Neighbors' Subsidy Spending	0.155*	0.131*
	(0.024)	(0.047)
Unemployment Rate	-0.049	0.141**
	(0.307)	(0.002)
%Δ in Manufacturing GSP	-0.014	-0.011
	(0.184)	(0.290)
Democratic Party Control	-0.058	-0.262
	(0.879)	(0.457)
Southern State	1.086†	0.772
	(0.065)	(0.120)
Rust Belt State	0.905†	1.328**
	(0.093)	(0.003)
R^2	0.13	0.32
N	286	286

Estimated random-effects GLS with p-values in parentheses
** p-value significant at .01 level
* p-value significant at .05 level
† p-value significant at .1 level

change in manufacturing GSP were insignificant predictors of average subsidy size. It appears as though the motivation to stay competitive with neighbor states and regions cuts across party lines and continues regardless of the state of the economy.

For model 1, the overall r-squared is 0.13. The model explains between state differences better than within state (time) differences, with the between r-squared being 0.2 and the within unit r-squared only 0.04. Alternative specifications were tried in order to explain more of the within state variance such as including a lagged dependent variable and dummy variable for year. These variables did not significantly contribute to the explanatory power of the model and the alternative models produced the same substantive results.

Before we dismiss strict capture as an explanation of the size of subsidies, recall that the literature tells us that strict capture is a characteristic of governing for which it is difficult to find statistical evidence, and our test demonstrates this point. An alternative specification may be that strict capture happens in specific instances rather than systematically across the states. Take the case of Nike in Oregon. Of the $2.5 Billion Oregon spent from 2006-2013 on subsidies, $2 Billion of it went to Nike in a single tax abatement package meant to retain the company's headquarters in Beaverton (GJF 2013). Nike was also a major campaign contributor in Oregon, giving $1,316,264 to candidates of both parties from 2004-2012 (National Institute on Money in State Politics 2014). An additional $1,387,285 was donated by employees of Nike (National Institute on Money in States Politics 2014).

Whether Oregon was substantially influenced by Nike to the point of being captured requires a closer examination in future work. Recall that in order to conclude a particular institution was strictly captured, there needs to be a clear movement away from the public interest toward industry interest. Whether Nike's interest is wholly different from the public interest is unclear as Oregonians benefit from the jobs and spending Nike adds to the local economy.

The cultural capture hypothesis incorporates the possibility that the public interest is actively defined by industry to be what is good for industry. Model 2 in table 3 presents the results of our test of the cultural capture hypothesis. The estimated effect of total business contributions on total state subsidy spending is positive and statistically significant. As contributions from business increase, states increase spending on subsidies for business, all else equal. This is strong support for the cultural capture hypothesis. From this evidence, we can conclude that the more business is active in politics the more they are able to garner a large political presence. Lawmakers interested in growing the economy, especially in pursuit of short-term re-election interests, turn to business to help in formulating policy. The relationship between government and business grows closer as the political power of business, by making numerous contributions, grows. The public interest, at least as it is seen by lawmakers, begins to be defined by industry interests the more industry is involved in politics.

Economic competition, measured in terms of neighbors' total subsidy spending, is also a statistically significant predictor of total subsidy spending; As a state's neighbors increase their subsidy spending, the state increases its own subsidy spending. Unlike the first model, being a southern state does not predict higher total subsidy spending. While being in the positive direction, the point estimate for the southern

state indicator is not statistically significant. Being a rust belt state, however, does lead to higher total subsidy spending, all else equal. This finding could be due to higher taxes on individuals and corporations in the north compared to the south, leading to larger budgets and more money to spend on direct subsidies. Southern states, however, could counter with greater non-budgetary tax credits, rebates, or abatement. According to the model and consistent with our prediction, an increase in the unemployment rate led to an increase in total subsidy spending, all else equal. However, percent change in manufacturing GSP was not a statistically significant predictor of total subsidy spending.

For model 2, the overall r-squared was 0.31. The model explains a substantial portion of the differences between states (between r-squared = 0.51) but a small portion of the within state variance (within r-squared = 0.03). Like model 1, time controls were included but did not pass model F-tests.

Party control was not a statistically significant predictor in either model. This begs the question as to whether subsidy spending as an economic development policy cuts across party lines. Our hunch is yes, for two reasons. First, Witko (2014) argues that both parties have become more responsive to the interests of business and wealth. This is due to increased election parity and the need for campaign funds; candidates from both parties pursue allies in the upper class and industry in order to secure election funds. As a result, policy may become more inline with the economic interests of the economically well-off. This could be happening in the realm of economic development, also squaring with the finding that the majority of subsidy spending favors large, established firms. Second, Mettler (2011) shows that Democrats have become more active in using the tax code to forward their policy interests because of the difficulty of getting direct social spending through the legislative process. Although her study is on the national level, the same process could be happening at the state level as state parties polarize, albeit asymmetrically and at different rates (Shor and McCarty 2011). Democrats interested in creating jobs and stabilizing the labor market may use tax code subsidies and large incentive packages in lieu of direct social programs.

An Ever Closer Relationship between States and Industry

In this paper, we have leveraged a new and exciting data source–the GJF Subsidy Tracker–in two ways. First, we were able to use the data from the Subsidy Tracker to evaluate common predictions in the economic competition and development literature. We found a steady growth in the subsidies offered by states to businesses, in both total number and large subsidy packages. The vast majority of

subsidies offered are small, indicating that states use their tax code and grant programs to stimulate and support small and medium home-grown companies mostly. Nevertheless, the majority of the spending is on large subsidy packages to major manufacturing firms. Second, we used the data to evaluate our theory that campaign contributions are a mechanism by which business can culturally or strictly capture state government. We found support for our cultural capture hypothesis; increases in business contributions are positively associated with state subsidy spending. We also found little direct support for the strict capture hypothesis, although there are certainly instances where states break with their overall approach to economic development to offer large subsidies to preferred businesses.

Future work should look at the broader political picture in which economic development takes place. While numerous studies including our own demonstrate a strong basis for economic competition as an explanation for state economic development activity and spending, our study offers politics as an additional explanation. States whose politics are more dominated by business will favor business more in policy, even in a policy area in which there is a close relationship between business and government. What features of the political system temper this relationship remains to be seen. It appears from our test that party control is not one of them; both Democrats and Republicans have close ties to business leaders and those ties grow closer as campaigns become more competitive and campaign funds become more precious. Attention should be paid to descriptive statistics, statistical models, and in-depth case studies in order to fully assess the relationship between private business, democratic institutions, and economic development policy. For example, whether Oregon was substantially influenced to the point of capture requires more investigation, but their subsidy package to Nike certainly inflated the average subsidy size in Oregon and does not characterize their overall approach to economic development.

Looking at the larger picture, this study is a first step in studying a fluid and complex political phenomenon. Subsidies are decried by many political elites, but touted by many others, as evidenced by the Rick Perry vignette described in the introduction. Subsidies benefit individual ventures, but are advocated by business associations. Large incentive packages are dwarfed in number by small subsidies, but the large packages account for the majority of spending. The issue of economic development spending is wrought with puzzles and paradoxes indicative of the complexity of the American political economy and the need for scholarly attention. Understanding the political and economic dynamics behind the provision of subsidies is a critically important task for academics, especially in the age of growing inequality.

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