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Choosing which firms to help in crisis: evidence from the emerging European economies

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Abstract: Decisions over state assistance to firms can hinge on whether politicians choose a strategy that favors particular interest groups, targets aggregate economic performance, or both. Which types of firms are more likely to receive financial help from the government? While standard interest group based explanations tend to see special interests dominating the political process, extraordinary economic challenges, such as financial crises, may make general economic concerns a greater priority for politicians. We argue that during financial crisis, politicians – who are always concerned with the economy – are even more likely to prioritize broad economic growth over helping particular groups. Politicians should favor general economic strategies over helping specific groups of firms because they have limited resources and wish to avoid sending a bad signal to other firms about helping those that fail. Using 2010 World Bank firm-level surveys done in Bulgaria, Hungary, Latvia, Lithuania, Romania, and Turkey, we find that politicians favored small dynamic firms with a proven ability to use resources well rather than the largest employers, those firms with the greatest lobbying capacity, or firms in particular sectors. We optimistically conclude that interest groups with disproportionate resources will not always get special treatment at the expense of others.

1 Introduction

“All financial crises are a fight over how much losses the government ultimately takes on. [Every decision] requires we balance how to achieve the most benefits in terms of improving confidence and the flow of credit at the least risk to taxpayers.”¹

¹ Timothy Geithner, April 27, 2009, *New York Times*.

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Although state aid is regularly offered to firms in good times and bad, government assistance is even more politicized in times of crisis. Economic difficulties heighten the sense of urgency for a government's actions and oftentimes pitch considerations of public benefits against the survival of private companies. At the heart of decisions about state assistance to firms is a choice about who to help.²

Politicians' desire to rescue private businesses with public funds may be driven by favoritism to special business or labor interests (i.e. special interest politics), or the pressing tasks of maintaining consumption and promoting recovery (i.e. concerns about collective social interests). Although politicians may pursue multiple goals, limited resources and concerns about market signals force leaders to make a decision about which goals to favor. In the context of financial crisis, are politicians likely to favor a strategy that caters to firms with the greatest lobbying capacity or general economic concerns? Or are politicians likely to pursue some combination of helping the most influential firms while pursuing policies that may be best for economic recovery? We argue that politicians are limited in which policies they can pursue. And during financial crisis politicians – who are always concerned with the state of the general economy – will favor strategies that improve the general economy and not special interests.

We disentangle two types of considerations – concerns based on special interest groups or collective social interests – that might determine a government's decision to support specific private companies during times of economic crisis. In doing so, we seek to determine which characteristics of firms' position and performance governments were likely to prioritize in their decisions. There are two advantages to studying this particular empirical context. First, economic crisis creates ideal circumstances in which to observe how politicians respond to competing pressures as more demands are being made on limited state resources. Second, the special economic position of banks in the domestic and international economy constrains government's decisions in a unique way. The banks' role in causing the 2008 financial crisis combined with their essential functions in anti-crisis programs makes financial sector experience hardly generalizable to the broader domains of economic policy choices.³ By looking at the non-financial part of the economy (also referred to by economists as the "real economy"), we can therefore obtain a broader understanding of the firms that are likely to receive aid and gain meaningful insight into the politics of business-state relations.

² We would like to thank Andrew Roe for research assistance. For useful comments and suggestions, we would like to thank Andy Baker, Carew Boulding, David Brown, Moonhawk Kim, Tom Mayer, Joseph Schaffer, Jaroslav Tir, Kathy Wu, Harvey Palmer, Jason Sorens, Jim Batista, Christina Boyd, Philip Arena, and two anonymous reviewers. All errors are our own.

³ Johnson and Kwak (2010).

Unlike past research that focuses on the aggregate outcomes which are indicative of underlying interest group politics, our empirical approach is novel in drawing on micro-level firm data to test which firms politicians will favor. To test our expectations, we use 2010 firm-level survey data from the World Bank's enterprise survey conducted in Bulgaria, Hungary, Latvia, Lithuania, Romania, and Turkey. Since all of these countries are competitive democracies and are EU members or candidate countries, these data allow us to determine why some firms are more likely to receive aid by allowing us to examine the behavior of firms in comparable regime types and under a similar set of regulations governing economic policy.⁴ All six countries were also hurt by the 2007 economic crisis so that their governments faced similar challenges in responding to worsening economic conditions at the time of the survey. In short, these data are a good basis on which to study the types of firms receiving assistance. Finally, an advantage of studying EU member and candidate countries is that it controls for a common regulatory environment. The European Commission has developed a set of rules to guide state aid decisions and ensure that national and EU-provided funds are used wisely. These criteria cap the amount and duration of aid, specify formal eligibility criteria for different types of assistance, and establish procedural guidelines.⁵ Although Turkey, as a candidate country, is not bound by the same restrictions, it often adheres to the EU guidelines as well; in fact, Turkish leaders may feel more pressure to adhere to EU restrictions given its uncertain status.⁶

The results of our empirical analysis using 2010 World Bank firm-level survey data support the notion that general interests can prevail over special interests. Evidence of the success of general interests over particular ones is a novel and important contribution: interest group literature in the Olsonian tradition emphasizes that organized interest groups who are better poised to overcome the collective action problem are more likely to be favored with things like financial assistance.⁷ We find, however, that in this context, general interests prevailed over the more organized specific interests. European politicians in the recent global financial crisis favored assistance to small firms that had demonstrated an

4 Although our theoretical analysis is tailored to democratic politics, special and collective social concerns are not specific to democratic governments. Previous research has demonstrated that the economic policy of non-democratic governments is significantly constrained not only by elites (Treisman 1996; Reuter and Gandhi 2011) but also by the citizens (Yap 2003).

5 European Commission. "Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, 2008/C 155/02." In: *Europolitics*. 14.

6 Schaffer (1998).

7 Olson (1965).

ability to use resources effectively, a strategy consistent with the goal of bolstering the general economy and not rewarding failures with aid. Contrary to popular accounts of bailouts and state assistance which focus on the undue influence of powerful players, our findings optimistically suggest that the implications of interest groups theories might not be as universally applicable as previously suggested and that economic crises may induce politicians to pursue strategies that help the general economy rather than just particular groups.

Our research has broader implications for political motivations in choosing economic policies and electoral strategies. One strain of literature has focused on politicians' incentives to promote general economic well-being including consumption and growth over time.⁸ Another body of literature focuses on how politicians use targeted spending and benefits to attract voters (including in authoritarian regimes).⁹ Existing research does not draw a clear conclusion about whether one of these political logics (the general economy or special interest groups) is most common or whether both can simultaneously exist. Our work, however, contributes a better understanding of when the dynamic favoring general economic concerns prevails by highlighting the important role of financial crisis.

2 European aid to firms amidst the 2007 financial crisis

State assistance programs in European countries from 2007 to 2010 allowed national governments to offer a variety of forms of state assistance although aid was subject to specific EU guidelines. In December 2008, the EU introduced a Temporary Framework to allow for even more extensive state aid in response to the financial crisis through the end of December 2010.¹⁰ Although the EU provides a regulatory framework, national governments can and do exercise a great deal of discretion about which firms to help. In fact, national governments have so much freedom to choose which businesses to help that some analysts advocate stronger guidelines based on promoting aid to the types of firms which are most likely to benefit from receiving assistance.¹¹ Contrary to calls for more restrictive eligibility criteria, the national governments considered in this paper – Bulgaria,

⁸ Przeworski (1991); Beck (1988).

⁹ Dixit and Londregan (1996); Lindbeck and Weibull (1993); Magaloni (2006).

¹⁰ See the European Commission's 2011 working paper, "State aid in the context of financial crisis" available at: http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.html.

¹¹ European Commission (2009).

Hungary, Latvia, Lithuania, Romania, and Turkey – offered such broadly defined state aid packages.

Aid programs addressed a variety of goals. Some examples of aid given by the European countries suggest that politicians often handed out aid to bolster economic activity and employment. In some cases, aid explicitly targeted firms that were considered to be structurally important to national economies. For instance, in July of 2010, the Bulgarian government announced an Investment Encouragement Act intended to promote high-tech industries and research and development.¹² In other cases, the government gave aid to firms explicitly to support employment or compensate the recently unemployed. In June of 2010, Romania announced that it would offer assistance to firms that create at least 100 jobs and invest at least 10,000 euros; it was anticipated that these measures would help create around 5000 jobs.¹³ In February of 2012, the EU also approved measures in Romania to help fund the layoff program at the state-owned CNH coal mine which was being shut down.¹⁴ Additionally, both Hungary and Latvia had programs that specifically targeted job training to bolster employment (European Commission, Chapter 3 of Annex IV of the Accession Treaty).

According to EU reports, from 2008 to 2010, about 84 percent of all aid offered by EU member states was directed towards common policy objectives and did not target specific sectors. In Bulgaria and Lithuania, all state aid was directed to common policy objectives rather than particular sectors. Likewise, in Latvia virtually all state aid went for common purposes (more than 99 percent). Romania and Hungary also devoted the majority of their aid to broad policy areas rather than particular sectors with 71 and 55 percent of aid going to general objectives and not specific industries, respectively.¹⁵

There is some evidence that national governments may have had an incentive to target smaller firms for assistance. EU reports and guidelines have emphasized

12 Global Insight, 15 July, 2010, “Bulgarian Government Unveils Revised Investment Encouragement Act.”

13 Xinhua General News Service, 23 June, 2010, “Romania to provide state aid to job creation companies.”

14 Romania Today, 29 February, 2012, “Romania approves EUR 49mill state aid to enhance closure of CNH mines.”

15 All of these figures are taken from the European Commission’s 2011 working paper on “State aid in the context of financial crisis” which is available at: http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.html. The figures cited here are based on what the EU classifies as “non-crisis” aid. In EU terminology, “crisis” aid refers to assistance specifically to the financial sector. The survey data used here does not include firms in the financial sector. Despite its name, “non-crisis” aid did in fact include assistance given to firms that suffered due to the 2007 global financial crisis.

the importance of assistance to small and medium-sized enterprises (SMEs) and national governments have adopted aid programs specifically targeting these firms.¹⁶ However, state aid programs do not overwhelmingly restrict eligibility to small and medium-size firms. In all of the East European countries considered here, less than 1 percent of total state aid was directed towards SMEs.¹⁷ Although these figures capture the size of aid and not eligibility rules directly, it indicates that large firms are typically candidates for some form of state aid even if they are not eligible for SME-specific programs.

The wide variation in European state aid programs from 2007 to 2010 raises the question of which firms were actually more likely to get assistance. Did state aid reach different sectors and different size firms, or did politicians favor firms of specific size or type of activity? Did politicians opt to favor firms with the most employees, catering to labor interests? Or did they target firms with the greatest market power that is often associated with a greater lobbying capacity? Next, we offer a theoretical basis on which to evaluate why some firms would be more or less likely to receive assistance in this particular context.

3 Politicians' motivations to give financial aid to businesses

We consider state aid specifically in the form financial assistance to individual firms. State aid, of course, can also refer to a variety of other forms of assistance including subsidies and tax breaks. Unlike other forms of aid that often support businesses indirectly and in the long run, direct financial assistance provides instantaneous relief during a time of crisis. It may be extended to all kinds of firms, irrespective of forms of ownership, sector, and market share and is an appropriate indicator of short-term political preferences. Financial assistance is also directly captured in the available survey evidence.

A long line of research in comparative political economy examines why politicians favor particular firms or particular economic policy strategies.¹⁸ We

¹⁶ See the European Union's 2009, "Handbook on Community State Aid Rules for SMEs" available at: http://ec.europa.eu/competition/state_aid/studies_reports/sme_handbook.pdf.

¹⁷ See the European Commission's 2011 working paper on "state aid in the context of financial crisis" which is available at: http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.html.

¹⁸ Fan and Schaffer (1994); Keefer (2007); Grossman and Helpman (1996); Hellman (1998); Maxfield (2003); We refer here to politicians because these are the actors responsible for designing bailout packages and those who are most directly held accountable by the public for bailout deci-

start with the standard assumption that politicians are motivated by winning elections.¹⁹ Electorally-minded politicians care about the economy because it drives the support from two types of groups, special interest groups and voters. Special interests, including business interests, will lobby politicians to promote the policies those groups prefer. These interest groups have the power to make campaign donations and mobilize voters, which makes their support important for politicians' survival. The average voter, of course, also cares greatly about the economy. Voters are especially concerned with incomes and consumption, i.e. their access to a variety of affordable goods.²⁰

In their quest to win elections and stay in office, politicians have to balance special interests and voters' demands. Existing explanations, however, tend to focus on either politicians' desire to cater to special interests or the general welfare and lack insight into what affects the tradeoff and when one group is likely to receive more attention. The first explanation of financial aid to firms sees politicians as responding to special interest pressures. Politics, from this perspective, is not just a matter of choosing the most popular policies, but rather responding to competing demands of important social groups, who use their political and economic leverage to support the reelection of politicians they like. Traditionally, capital and organized labor are considered the most politically influential of such special interests. The special interests argument sees the political influence of corporations and labor groups as major reasons why politicians should favor particular firms in allocating state aid.

The second explanation of financial aid to firms operates under the assumption that politicians are concerned with collective social interests related to economic performance (e.g. high growth, low unemployment, economic stability, etc.). In democratic countries, national economic performance, particularly in the short to medium term, directly affects politicians' prospects for reelection.²¹ In the context of financial crisis in democracies, a concern with the general economy is an especially plausible assumption because politicians depend on popular support to stay in office. Improving the national economy suggests that aid allocation should be driven by the desire to increase aggregate output, efficiency, and consumption.

sions. Although bureaucrats are involved in the technical work required to allocate aid, politicians are responsible for passing the legislation according to which bureaucrats operate. Politicians are also at the greatest risk of losing their jobs if bailout decisions reflect badly on them. Therefore, we consider it appropriate to refer to politicians as making the decisions about firm-level bailouts, and not bureaucrats, who we consider to be intermediaries rather than the key decision makers.

19 Downs (1957).

20 Baker (2009); Beck (1988); Przeworski (1991).

21 Przeworski (1991).

While both explanations reflect politicians' concerns for political survival, the first emphasizes strategies pleasing special interests whereas the second focuses on general welfare concerns. Existing research provides little insight into whether these motivations exist simultaneously, or whether special interest concerns predominate sometimes and general welfare at other times. On the one hand, politicians may face trade-offs imposing hard choices as to which policies to pursue. On the other hand, politicians are likely to benefit most when simultaneously improving the general economy and catering to special interest groups. Below, we develop clearer expectations about why the government may choose to prioritize the general welfare over particular groups during times of financial crisis.

Special Interests. There are several mechanisms by which special interest groups may disproportionately influence state aid allocation priorities. Firms with the greatest lobbying capacity may be the most likely to receive assistance. A firm's financial resources are an important determinant of its lobbying power as has been extensively demonstrated in the American context.²²

Financial resources can be used to gain other advantageous lobbying resources including access to the government and may facilitate the development of political connections, which have been found, unsurprisingly, to help secure corporate bailouts.²³ In short, firms that concentrate significant financial resources (these firms usually enjoy a greater share of the market) should be more likely to influence the government and, therefore, are more likely to receive assistance.

Although financial resources should give a firm a significant advantage, studies of interest groups and lobbying have shown that money alone does not buy political influence. Vogel, for instance, notes a decline in the political influence of business in American politics from the mid-1960s to the mid-1970s.²⁴ Recent research has further shown that human capital can be more important than financial capital for determining an interest group's influence.²⁵ Regarding state aid to firms, leaders may be sensitive to the number, organizational capacity, and political influence of workers employed in the firm. Pressured by organized labor demands, politicians might strive to help firms that employ more workers. Corporations might also use politically favorable labor justifications to support

²² Gordon and Hafer (2005: pp. 245–261); Grossman and Helpman (1994: pp. 833–850); Grossman and Helpman (2001); Langbein (1986); Plotke (1992); Schlozman (1984); Wright (1989); Yackee and Yackee (2006).

²³ Wright (1990), Faccio, Masulis, and McConnell (2006).

²⁴ Vogel (1983).

²⁵ Barakso, Gerrity, and Schaffner (2011: pp. 557–580).

their claims for state protection. This makes sense as we often see complaints about the outsourcing of jobs being used as a justification for protectionist measures. If this applies to bailouts, then firms that employ large number of workers should be the most likely to receive aid.

Related to this, leaders might be particularly interested in helping firms located in close proximity to the centers of political power. Firms located in major urban areas may be more likely to interact with national and local politicians and civil servants and reach out to the media and political pressure groups. Lay-off decisions for such firms are likely to aggravate citizens that are comparatively more politically active and well-organized.

Although lobbying figures prominently in the scholarly accounts of economic policy making, preferential treatment of specific companies may not depend on the actual acts of political contributions or explicit demands by private companies. Politicians may target specific companies due to their unique positions of structural importance to the economy.²⁶ Przeworski concludes that, “A science of politics that ignores economic constraints on popular sovereignty misses what all democracies have in common, namely, that they exist in societies where the future of all depends on the decisions of some, those who control productive resources. Popular sovereignty is constrained by private ownership of collective resources.”²⁷ This implicit power of businesses can be understood in terms of the exit, voice, and loyalty game.²⁸

While voice and loyalty entail specific (and costly) actions on the part of business community, the mere threat of using the exit option – meaning that business would relocate or cease to operate – can be sufficient to exert powerful leverage on politicians.²⁹ Even the most public-minded politicians, therefore, may favor firms that they think matter most for the growth of the national economy regardless of whether these firms lobby. The implicit threat of a firm’s exit should be sufficient to garner preferential treatment from the government. The firm’s position of structural importance, therefore, provides similar predictions about the allocation of aid under the special and general interest theories.

The political dynamic of special interests suggests that politicians benefit by helping wealthy firms, which can directly help them win elections, or which can help improve (or avoid damaging) the general economy – this should also help politicians win elections. In either case, the focus is on wealthy firms and less – if at all – about broader economic concerns. Even in terms of the exit, voice, and

²⁶ Frieden and Rogowski (1996: pp. 48–78); Bernhagen and Brauning (2005).

²⁷ Przeworski (1991: p. 16, 2008).

²⁸ Hirschman (1970).

²⁹ Lindblom (1977).

loyalty game, the issue is more about preventing damage to the economy than about promoting general long-term growth. Contrasting with this, we turn next to politicians' electoral motives to promote the general economic welfare.

General Well-Being of the Economy. In a sharp contrast to the special interest explanations, other accounts stress overall economic performance as the major objective of a democratic government. This logic is supported by empirical and theoretical research which indicates that in democracies electoral considerations mean politicians are concerned with the preferences of the average citizen in choosing which economic policies to pursue.³⁰ Other work has shown that electoral accountability encourages politicians to think about general economic welfare.³¹ Employment, output, and consumption are of major significance to voters.

Politicians take the issue of employment into serious consideration in making economic policy. Because politicians care about the effectiveness of their policies in maximizing employment and maintaining consumption, they have to allocate aid to companies that would add or retain the most workers for a given amount of assistance. Although large employers can supply many potential jobs (and voters), most jobs are located in the small business sector. In the analyzed countries small and medium size firms employ between 65 and 77% of labor force. In Western Europe small firms experienced a surge in growth in the 1980s, which made them increasingly important parts of the economy.³² In the 1990s, fueled by new economic freedoms and mass privatization campaigns, transitional economies of Eastern Europe experienced immense growth in the small business sector. Although the labor productivity of small firms is lower than average (primarily due to the higher productivity in capital-intensive large firms), in countries like Romania, Turkey, and Latvia, small businesses generate between a half and three quarters of the value added to the economy.³³ Table 1 gives a breakdown of the statistics by company size. The vast majority of firms have less than 10 employees per firm.

The small business sector is considered to be the primary engine of job growth.³⁴ Small companies that are not as extensively bound by employment contracts are also more likely to lay off workers in difficult times. Large employers, on the other hand, usually have a more constant demand for labor and may not

30 Mesquita et al. (2003); Kono (2008); Weyland (2002).

31 Ferejohn (1986); Besley and Case (1995); Beazer (2015).

32 Brock and Evans (1989); Julien (1993).

33 Eurostat. Key figures on European business with a special feature on SMEs. July 2011; European Commission. Enterprise and Industry. 2014 SBA Fact Sheet. Turkey. 2014.

34 Storey (1994); Welter and Smallbone (2003).

Table 1: SMEs by enterprise size class, percent of non-financial business economy, 2011.

Firm size (# employees)	Number of enterprises			Percentage of population employed			Value added at factor cost		
	0–9	10–49	50–249	0–9	10–49	50–249	0–9	10–49	50–249
Bulgaria	90.9	7.5	1.4	30.2	23.6	21.7	16.8	19.9	22.5
Hungary	94.8	4.4	0.7	35.8	18.5	16.7	19.4	15.7	18.6
Latvia	88.8	9.2	1.7	30	25.1	23.7	16.3	23.8	27.5
Lithuania	90	8.1	1.7	25.7	25.6	24.8	13.1	23.2	29.8
Romania	87.1	10.6	2	22.5	22.4	21.4	12.9	15.9	Missing data
Firm size (# employees)	0–19	20–49	50–199	0–19	20–49	50–199	0–19	20–49	50–199
Turkey	97.3	1.8	0.8	46.5	12.3	16.9	19.6	12.7	20.6

Source: For EU countries – Annual enterprise statistics by size class for special aggregates of activities (NACE Rev. 2), for Turkey – Eurostat 2011, Key figures on European business with a special feature on SMEs. Data are collected by countries' national statistical units through statistical surveys, business register, or administrative sources. Value added is the gross income from operating activities after adjusting for operating subsidies and indirect taxes.

lay off workers as easily as smaller companies. Politicians might see significant employment gains in supporting a dynamic small business sector. Consider, for instance, that in the data used in this paper smaller firms are more likely to lay off workers (there is a negative correlation of 0.07 between the number of workers employed by a firm and its projected future layoffs). Therefore, politicians may prefer to favor smaller firms for whom employment is more variable.

There is further evidence that small firms are important for the economy and that international organizations have worked to bring the importance of supporting small firms to the attention of politicians. Because of the growing number of SMEs and their importance for the economy, international organizations have touted small firms as an important target for assistance. OECD reports highlight the importance of SMEs in spurring economic growth by advancing innovation and productivity. They refer to financing SMEs as a “key to economic recovery.”³⁵ Politicians concerned with promoting the general interest should, then, be concerned with supporting small firms.

A final important note is the size of loans given. In this paper, we do not address the issue of the amount of aid being given to a particular firm nor do we have data about the amount of aid. One might ask, however, whether the government is choosing to give many small loans to smaller firms instead of giving large loans to a few big firms. Given that it generally takes more resources to aid a large firm, preferences to award aid to small firms might be at least partly due to financial constraints faced by the governments. Still, this suggests that aid is awarded based on the concerns for the general economy: small firms are unlikely to have resources on the scale necessary to sustain mutually beneficial clientelistic arrangements with politicians.

In seeking to give aid that will spur a national economic recovery, politicians may also look to a firm’s economic need. On the one hand, the neediest firms might be the most eligible candidates to receive aid. On the other hand, giving aid to the very worst may create perverse incentives for firms seeking assistance, because a firm’s bad performance might stem from poor business management rather than adverse effects of external economic shocks. Rewarding bad performance with aid would send the wrong signal to firms, prompting them to reduce production, employment, or short-term revenues to qualify for state aid.

³⁵ Organization for Economic Cooperation and Development. “Recent Trends in SME and Entrepreneurship in Finance.” In: OECD, 2013. Chap. Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard; Organization for Economic Cooperation, Development, and Asian Development Bank. ADB-OECD Study on Enhancing Financial Accessibility for SMEs: Lessons from Recent Crises. Tech. rep. Organization for Economic Development, Cooperation, and Asian Development Bank, 2015.

In order to avoid adverse selection, leaders who want to use limited public resources wisely should assist firms that are likely to provide the highest returns. State-provided bailouts, however, create a principal-agent game in which it is difficult for the state to monitor firms' behavior after money has been given. In screening for firms that are likely to provide the highest returns on public aid, government agencies can only incorporate previously revealed information about a firm's prospects for utilizing financial resources. While the logic of this approach is entirely prospective, state bailout decisions can only be based on the retrospective evaluations. Because voters care about short-term economic performance, it may be sufficient for politicians to claim they are keeping otherwise healthy companies from collapsing during a crisis. As such, retrospective evaluations by both politicians and voters would result in assisting firms who have shown signs that they will use funds wisely. Work examining political support in times of crisis has emphasized that politicians must address voters' immediate consumption demands in order to stay in office.³⁶

When considering general welfare, politicians will assist firms whose performance either matters for employment, output, and productivity. For these explanations, the focus is on what ultimately makes the average voter happiest and is, therefore, most likely to win her support at the polls. The focus is not on appealing the largest firms.

Theoretical Expectations. According to the special interest groups' perspective, capitalists and workers are potential beneficiaries of state aid. The capitalists may be influential due to their lobbying resources or due to the structural importance of their firms for the economy. The workers may be influential because of lobbying and electoral power. The consideration for these two groups may overlap in a given firm and government bailout strategies may reflect concerns for both. Conversely, politicians may favor one group over the other. According to the other perspective which focuses on the general welfare, politicians have incentives to use state resources to promote economic performance, meaning they should prefer firms for whom assistance will make a difference either in terms of bolstering production or maximizing aggregate employment.

The competing pressures to allocate state assistance create tradeoffs for politicians. McGillivray notes, for instance, that we must consider not only the industries that politicians want to protect through trade tariffs, but also those that politicians are able to protect within the constraints of the political system.³⁷ This suggests that although politicians could pursue both special interest and

³⁶ Magaloni, Diaz-Cayeros, and Estevez (2007: pp. 182–205); Healy and Lenz (2012); Huber, Hill, and Lenz (2012).

³⁷ McGillivray (2004).

general economic goals, the constraints imposed by limited fiscal resources may force them to choose between the two strategies. Furthermore, our discussions suggests that politicians wish to signal goals uniquely associated with either promoting general economic growth or assisting firms with the greatest lobbying capacity.

These explanations reveal a tension between two types of potential mechanisms linking firm characteristics and aid allocation priorities. Notice that firm characteristics, such as the size of its labor force, market power, structural importance, and economic performance figure prominently in both types of accounts, but in different ways.³⁸ Large companies (in terms of market share and employment), for instance, are associated with greater capacity to extract state aid and hence would be the primary candidates for aid allocated by interest groups politics. The general interests' account, however, would see large employers as being less effective in turning state aid into new jobs and hence less likely to receive aid from politicians concerned with the aggregate employment. Firms that are most adversely affected by the crisis might have the strongest impetus to lobby for aid, but such firms are least favored by politicians concerned with the state of economy.³⁹ In sharp contrast to the special interest accounts, the general economic rationale would also suggest that all other things being equal, states should target companies with fewer, rather than more, financial resources.

Below, our empirical analysis evaluates the alternative strengths of these two competing explanations of government economic policy making – motivations based on special or general economic interests – in the specific case of the East European financial crisis state aid decisions. We use this case of crisis politics to test explanations derived from two prominent theoretical traditions in studying state policy-making. Specifically, we concentrate our analysis on firm characteristics associated with greater political influence – a large labor force, market share, export location, the type of sector, and urban/rural location – or the greater potential for turning state aid into productive use – strong economic performance, small size, and a lack of alternative financial resources. If we are wrong that during financial crisis politicians will prioritize one strategy, this will be reflected in our results.

In Table 2 we summarize our theoretical expectations about the relationship between these firm characteristics and state allocation decisions under the

38 The only exception is a firm's structural importance, for which there are similar predictions under special and general welfare theories.

39 Previous research showed firms with declining output and shrinking employment figures have been more likely to receive government assistance (Marvel and Ray 1983: pp. 190–197; Ray 1991: pp. 169–187).

Table 2: Effects of firm characteristics on state aid allocation: summary of theoretical expectations.

Firm characteristics	Interest group politics	General economic concerns
Firm's market share	Corporate influence by size firms drives aid allocation	No expectations
Size of labor force	Large companies with organized labor and corporate influence receive aid	Small businesses receive state aid because they create more jobs
Structural importance	Firms' in important sectors receive state aid	
Firm's location	Because of lobbying advantages firms in larger cities receive aid	No expectations
Firm's performance	Economically distressed firms lobby the state to receive aid	Firms in better economic standing receive aid because they can use it well
Financial resources	Financial resources support lobbying and improve firms' chances to receive aid	State aid allocated to capital-scarce firms offers high social returns

theoretical frameworks of special interests and general welfare interests. All but one of these theoretical expectations offer clear testable propositions for distinguishing interest group centered explanations of aid allocation from those consistent with concerns for improving the economy at large.

In responding to the financial crisis that began in 2007, we expect that politicians would be more likely to eschew an approach that caters to special interest groups. During crisis, general economic recovery is often cited as the main goal. If this is true, then we should not see aid favoring particular interest groups. We agree with McGillivray who notes that we must consider not only the interests that politicians want to protect, but also those that they can protect within the constraints of the system.⁴⁰ When facing a financial crisis in a competitive democracy, politicians still have incentives to cater to special interests, but have even stronger incentives to focus on the general economy, which is at the center of political debates and public discourse. Politicians may not always prioritize aggregate economic performance in regular times, but economic crises may force their attention to focus more heavily on broader goals.

As we note above, we assume that politicians are primarily office seeking and that there are electoral incentives to favor both the general welfare and specific groups. We argue that during times of crisis office-seeking politicians will

⁴⁰ McGillivray (2004).

be more likely to cater to general welfare over particular interest groups. Financial crisis results in a large group of diverse people who are upset with current conditions. In order to maximize their support or at least minimize opposition at election time, a politician should seek to improve conditions for the greatest number of people possible and to do so as quickly as possible. Limited resources with which to provide assistance means that it should be more difficult to decide to boost the general economic welfare and cater to special interest groups simultaneously. The key is not future economic recovery—which may happen well after elections—but stimulating short-term economic performance.

Although our focus here is on the characteristics of firms, there are important national conditions that we take into account. We control for national economic conditions such as changes in GDP and the central government's budget balance. We also consider the lobbying environment in which firms are applying for and receiving aid. Countries with more organized business (as measured by membership rates in industry associations) are countries in which business lobbying may be more likely to occur. While there is little evidence from Eastern Europe that formal interest organizations are effective in lobbying state institutions, industry associations may have a positive effect on applications for bailouts if they are useful in spreading information related to the market and government policies to firms.⁴¹ For instance, they may inform firms in their industries about the availability of assistance and how to apply for it. If professional associations are primarily used for information dissemination and not lobbying, then the density of business associations should not affect who receives aid even if they influence who applies for it.

Finally, to test our hypotheses regarding aid allocation, we must take into account which firms apply. The data we have available anonymize firms so that it is not possible for us to know for which programs an individual firm was eligible to apply, although we do have a good idea of the general types of state assistance being offered as discussed above. We cannot take a strong stance on why some firms apply over others because we have limited information regarding for which aid programs specific firms were eligible. We are comfortable, however, making the assumption that the ultimate control rests with politicians who pass the legislation creating aid programs in the first place.⁴²

⁴¹ Duvanova (2007, 2011); Pyle (2011).

⁴² We also consider the possibility that the type of electoral system might influence politicians' strategies. We estimated the models presented below and included a district magnitude variable from the Database of Political Indicators (Beck et al., 2001). The main results do not change. In this case, however, we are only dealing with 6 countries making it impossible to draw any strong conclusions about the effect of electoral systems on this particular outcome.

4 Empirical evidence

4.1 Data

To test our expectations we use a panel of 2 consecutive surveys (with six-month intervals) conducted by the World Bank in 2010 in Bulgaria, Hungary, Latvia, Lithuania, Romania, and Turkey. The survey was conducted by the World Bank Enterprise Survey Unit. The research team followed their standard sampling methodology but used a specially-designed questionnaire to target crisis-related experiences. The first wave of the survey was conducted in the summer of 2009 but did not include the question about whether a firm received state aid. We analyze the data from the second and the third waves of the Crisis Survey held in February and March of 2010 and in the summer of 2010. The survey was only conducted in these six countries. In the third wave, the survey was expanded to include Kazakhstan, but the pattern of state aid distribution was different there. In Kazakhstan, state aid was administered from the special crisis assistance fund Samruk Kazyna that targeted large companies only and did not require companies' application. As a result, we did not include the Kazakh observations in our statistical analysis. The goal of the survey was to assess the impact of crisis on firms' performance and business climate. It targeted the issues of access to finance, employment, and sales growth. One of the questions asked whether firms applied for and received financial aid from state institutions. In 3295 observations, 6.2 percent applied for state aid and 3.98 percent received it, meaning about 36 percent of those who applied did not receive assistance.

Although our research question is not limited in scope to the post-communist European countries and Turkey, it is an advantage that 5 of the 6 countries included in the survey share this common legacy. All of these countries underwent transitions to democracy and the market at roughly the same time and are among the new European Union members. Turkey, of course, is not post-communist but shares the experience of being a relatively new candidate country in the European Union. We can therefore somewhat control for a common legacy and a similar – though not identical – position within the European Union.

Based on existing explanations and our own theoretical expectations, we have the following set of firm-level explanatory variables, all of which are operationalized using the World Bank's crisis survey data. First, to test the hypothesis about special interest politics we consider a firm's market share, size, and geographic location. A firm's market share captures the self-reported size of the firm relative to its product market. We also consider the size of the city in which the

firm operates on the expectation that firms located in larger cities might have better lobbying opportunities.

Second, to evaluate the competing special interest and aggregate employment considerations, the labor force is measured in terms of a firm's permanent employment at the time of the survey. Positive relations between firm size and aid receipt would lend support to the special interest groups' explanation, while a negative relationship would be consistent with the account based on general economic motivations that emphasizes the employment gains from supporting small business.

Third, to evaluate competing propositions in respect to financial resources and firms' potential to use aid well, we assess a firm's performance and vulnerability to financial melt-down using revenue, financial, and fixed capital constraints. Changes in a firm's sales (compared to the same period in the preceding year) capture the revenue constraints. Because of heterogeneous production and market conditions, similar changes in firms' sales might indicate different levels of economic distress experienced by firms in different lines of business. Hence, we use an ordered scale measure with three categories for "decreased," "stayed the same," or "increased" reflecting changes in sales. We consider a firm's ability to finance its operations from internal funds rather than relying on external financing as an indicator of strong economic position. Clearly, firms that rely on external funds are more vulnerable in times of financial crises, while those who can generate internal sources of financing have independent engines of good performance.

We consider the argument that bailouts target the best performers who exhibit strong growth potential by including a self-reported estimate of current capacity utilization (as a share of a firm's optimal output). Depending on the specific government and bailout package, firms were required to provide different information about their performance and use of resources. We use this self-reported variable to capture how individual firms would have represented their own performance to the government. Because this is a retrospective and self-reported variable, it is likely to best reflect the information that firms provided to the government in making their applications. Furthermore, there is no incentive for a firm to lie on the survey as responses are anonymous and are not tied to aid decisions.

Finally, although firms' structural importance characteristics do not distinguish between explanations based on special and general economic interests, we feel compelled to control for such effects in the empirical application. A firm's structural importance is captured by its sector and exports. We use dummy variables for secondary and extractive sectors with services treated as an excluded category. Although the countries we analyze are generally similar in the sectoral

composition of their economies, systematically important sectors might vary from country to country. To fully capture sector-specific effects we also use sector-country dummies, making sure that our main results are robust to such specifications.⁴³ Exports are measured as a share of exported goods and services in a firm's current sales.

We include several country-level factors to control for a state's ability to provide assistance and also to take into account the economic environment in which firms are applying. These variables include GDP growth (contraction), the central government's budget balance, and industry associations' membership density. GDP growth captures the degree to which economic crisis impacts the real economy, meaning the non-financial sector. We expect that the effect of a crisis on the real economy may impact state assistance priorities. We include the density of industry associations as a percentage of all firms to account for the extent of business organizational capacity.⁴⁴ Because of the limited variation (6 countries over 2 time periods), we cannot make reliable inferences about the effects of country-level conditions nor is that the focus of our research here.

5 Estimation

Our dependent variable – state aid allocation – is a binary outcome that takes the value of one for firms that received the state aid, and zero otherwise. As a first approximation for testing the hypothesized effect of our independent variables, we estimate Probit regressions that include firm-level regressors only (Model 1) and the full list of firm- and country-level variables (Model 2). Results are reported in Table 3.⁴⁵ Because observations are not independent and T is small $T=(1; 2)$, we compute panel-clustered robust standard errors for all regression models used in this paper.⁴⁶ Our results generally refute the special interest-based explanations, while providing support for a strategy motivated by general economic concerns.

In the analysis, we must also take into account the fact that many firms have chosen not to apply for the state aid, which restricted the pool of potential aid

⁴³ Regression results including sector-country controls are included in the Appendix.

⁴⁴ This variable is generated based on the 2005 Business Environment and Enterprise Performance Survey data on membership in business associations. Unfortunately, we lack a more recent estimate of business association membership density in the region.

⁴⁵ Results from a “naive” model that includes only those firms who applied for aid are similar to those reported in Table 3 and are available from the authors. Results for country- and time- fixed effects logistic regressions can be found in the Appendix.

⁴⁶ About 60% of firms in our sample were interviewed twice.

Table 3: MLE Results (n=3137, panel-clustered robust standard errors in parentheses).

	Probit		Binomial probit	
Prob (aid=1)				
Full-time employment	-0.021	-0.034	-0.015	-0.017
100 permanent employees	(0.006)***	(0.006)***	(0.006)**	(0.007)**
Firm performance	-0.0006	0.003	0.0002	0.004
Capacity utilization, %	(0.001)	(0.001)**	(0.002)	(0.002)***
Market share	-0.003	-0.0009	-0.003	-0.0009
% Corresponding product/service market	(0.001)**	(0.002)	(0.002)*	(0.002)
Business growth	0.199	0.018	0.180	-0.006
Sales increased=1, same=0, decreased=-1	(0.038)***	(0.032)	(0.039)***	(0.036)
Internal financing	-0.002	-0.002	-0.003	-0.003
Share of operating costs	(0.0009)**	(0.0007)***	(0.001)*	(0.0008)***
Direct exports	-0.002	-0.00008	-0.002	-0.0006
Share of firm's sales	(0.0008)**	(0.001)	(0.001)**	(0.001)
Secondary sector	0.517	0.189	0.492	0.158
Sector dummy	(0.117)***	(0.129)	(0.124)***	(0.139)
Extractive industry	0.507	0.061	0.403	-0.027
Sector dummy	(0.138)***	(0.116)	(0.130)***	(0.111)
Firm location		-0.002		-0.002
City population, 100,000 residents		(0.002)		(0.0001)***
Δ GDP		0.027		0.017
Annual growth rate, t-1		(0.015)*		(0.027)
Government budget balance		-0.114		-0.130
t-1		(0.058)*		(0.064)*
Business organizations' strength		0.020		0.022
Membership in business organizations, % firms		(0.006)***		(0.008)**
Constant	-1.530	-3.870	-1.532	-4.074
	(0.241)***	(0.747)***	(0.261)***	(0.894)***

Table 3 (continued)

	Probit	Binomial probit
Prob (apply=1)		
Full-time employment	0.004 (0.012)	0.001 (0.015)
Firm performance	-0.003 (0.001)**	0.0007 (0.001)
Market share	-0.003 (0.002)	-0.0006 (0.002)
Business growth	0.189 (0.036)***	0.012 (0.034)
Internal financing	-0.003 (0.001)***	-0.003 (0.0006)***
Direct exports	-0.001 (0.001)	0.0002 (0.0012)
Secondary sector	0.439 (0.104)***	0.110 (0.096)
Extractive industry	0.435 (0.152)***	0.022 (0.112)
Firm location		-0.003 (0.0005)***
Δ GDP		0.031 (0.020)
Government budget balance		-0.115 (0.044)**
Business organizations' strength		0.019 (0.005)***
Constant		-3.341 (0.566)***
Log pseudolikelihood	-507.707	-459.208

***p<0.001, **p<0.01, *p<0.05.

recipients in a non-random manner. From a methodological standpoint we are dealing with a binary outcome – whether or not the firm received the state aid – and a binary “screening” regressor – whether the firm applied for state aid. Ignoring the latter regressor or considering only the sample of firms that applied for state aid is likely to bias the Probit estimates. Because firms’ decisions to apply is likely influenced by whether they expect their application to be successful, ignoring the screening process is likely to introduce selection bias.⁴⁷

Two estimation approaches are well suited for modeling the set of binary choices we have at hand. Instrumental variable regressions provide robust estimates when good instruments for estimating the treatment (in our case – the application decision) are available.⁴⁸ Such instruments, however, are hard to find with self-reported survey data. An alternative standard approach is to use a maximum-likelihood estimator (MLE) including Binomial Probit (BP) and Sample Selection (Heckman) Probit models. The specialized literature continues to debate the relative merits of these alternative models.⁴⁹ Because we are skeptical about the prospects of finding truly exogenous instruments for the application equation, we turn to the MLE models. Here the primary difference lies in how the screening process is modeled. While both the BP and the Sample Selection approaches treat selection and outcome choices (aid application and receipt) as determined by latent factors and assume that their error terms jointly follow normal distribution, the former estimates application and aid receipt in a system of simultaneous equations while the latter models selection and outcome equations (aid application and receipt) sequentially. We give preference to the BP approach because of the known efficiency of the maximum likelihood estimator, the robustness of BP models to the non-normality of error terms,⁵⁰ and the model’s good performance in smaller samples (<5000) when the treatment probability is close to 0 or 1.⁵¹ In our case, there are 3137 complete observations and the probability of application is 0.08. The BP simultaneous equations approach addresses our concern that the firm’s decisions to apply are driven by their informed guesses of whether they are likely to succeed in receiving state aid, and the associated problem of non-independence of the application and aid decisions’ equations’ error terms. In the

⁴⁷ Heckman has shown that these two biases are in fact equivalent (James Heckman. “Sample selection bias as a specification error.” In: *Econometrica* 47.1 [1979], pp. 153–61).

⁴⁸ Angrist (2001).

⁴⁹ Angrist (1991); Bhattacharya, Goldman, and McCaffrey (2006: pp. 389–413); Chiburis, Das, and Lokshin (2011).

⁵⁰ Bhattacharya, Goldman, and McCaffrey (2006), “Estimating Probit Models with self-selected treatments.”

⁵¹ Chiburis, Das, and Lokshin (2011), “A Practical Comparison of the Bivariate Probit and Linear IV Estimators.”

Appendix, we consider the Sample Selection alternative and find that our core findings remain robust to this different estimation method.

In what follows we estimate the following system of simultaneous structural equations:

$$y_{it}^* = \beta_1 x_{it} + u_{it}$$

$$y_{2it}^* = \gamma y_{1it} + \beta_2 x_{2it} + u_{2it}$$

Terms y_{1it}^* and y_{2it}^* denote the latent application and bailout probabilities, y_{1it} and y_{2it} are observed dummies that take the value of 1 when $P(y_{it}^* > 0)$, and x_{1it} and x_{2it} are explanatory variables. Because it is hard to think of important firm characteristics that affect application decisions but are completely unrelated to aid allocation, we include the same set of x independent variables in both equations.⁵²

We use the survey-based information on whether the firms: (1) requested state assistance and, (2) received bailouts in the 3 months preceding the survey to construct our screening and outcome variables. We use the STATA-biprobit command to estimate models that include only the firm-level regressors (Model 3) and firm-, location-, and country-level independent variables (Model 4). Table 3 reports the results for the application and aid allocation equations.

First, consider the models that include firm-level regressors only. Our analysis of firm-level covariates identifies several factors, including small size (both in terms of employment and market share), strong economic performance (sales growth), the lack of internal financing, and domestic manufacturing and primary sector location as influencing a firm's propensity to receive state aid. Some of these effects disappear once we directly model firm location and country-level economic conditions. All else equal, firms located in countries with stronger economies but lesser fiscal discipline are more likely to receive state aid and so are firms located in countries with stronger business organizations. Once these effects are taken into account, sectoral dummies, exports, sales, and market share variables lose their significance, but a firm's economic performance operationalized with the capacity utilization variable becomes a statistically significant predictor.⁵³

⁵² We do not make any assumptions about causal independence of these two stages in the decision process.

⁵³ We find that manufacturing sector dummy, which captures our expectations about strategic importance of manufacturing, persist in all model specification except the one including the country-level measure of industry organization. Once we control for country-wide membership rates, manufacturing dummy loses its significance. As we note earlier in the paper, given the nature of our data, the expectations about strategic importance are empirically indistinguishable from those based on the special interest argument.

We find these results to be consistent with the general economic well-being explanations that stress the efficiency-driven allocation of state resources to small and dynamic, but financially vulnerable firms. Contrary to the influence-based arguments, the size of the firm as captured by its employment has a consistent negative effect across our models. Figure 1 shows how the probability of bailout declines with firm size. Holding all other covariates at their mean or modal categories, an increase in the size of the workforce from 100 to 1000 people cuts the probability of receiving state aid almost in half. Although the change from the probability of 0.022 to 0.014 might seem substantively small, for the firms included in the sample the estimated probability of receiving state aid (after factoring in the probability of applying for the state aid and setting all independent variables at their mean/modal values) is only 0.02. Since we account for the potential effect of firm size on the decision to seek state aid, we are confident that our results are not driven by the fact that large employers might be less interested

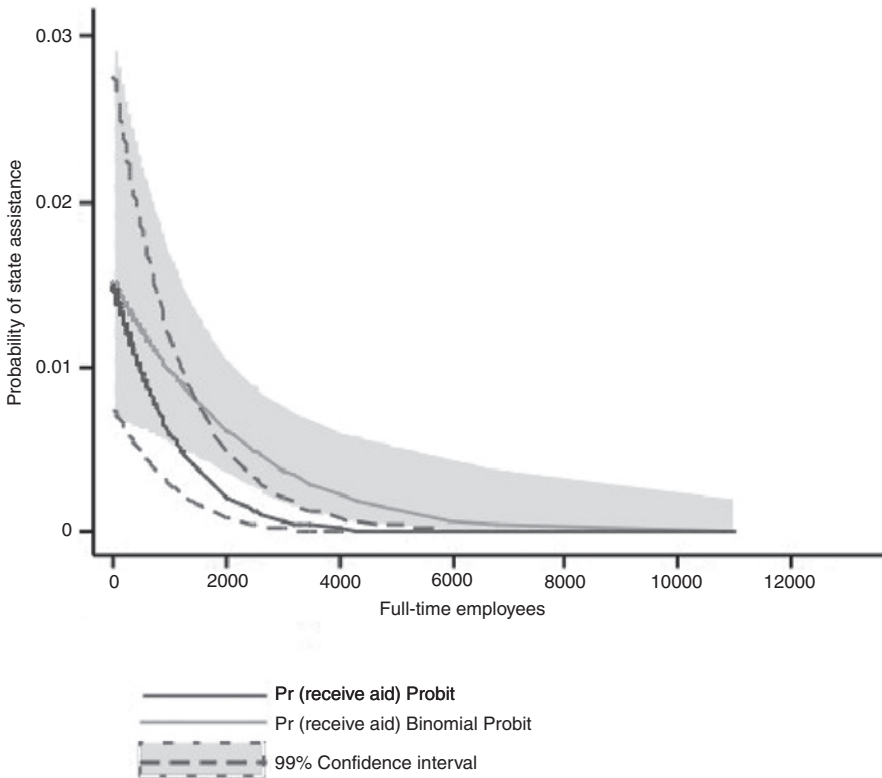


Figure 1: Effects of enterprise size on the predicted probability of state aid. (Covariates are set at mean/modal values).

in receiving state funding (because, for example, they avoid negative publicity associated with applying for the state aid and admitting their financial difficulty). The substantive effects of our performance measure (capacity utilization) are also non-trivial. All other things held constant, a firm that utilizes only one-third of its capacity is two times less likely to receive state aid compared to a firm with 100 percent capacity utilization (the corresponding probabilities change from 0.015 to 0.032).⁵⁴

Our results provide virtually no support for the influence-driven explanations: sectoral differences and the size of the firm relative to its market do not have any statistically significant effects after the introduction of the country-level controls. The capacity utilization variable, on the other hand, has a consistent positive effect on which firms receive aid. This supports our hypothesis that governments prefer to offer assistance to companies with a good performance record because of the belief that the funds will be used well. The general economic well-being explanation also receives some indirect support from the fact that firms located in smaller cities are more likely to receive state assistance if they apply (Binomial Probit regression). This finding rules out the possibility that the government is more concerned with the health of the private sector in larger locations because they have stronger political influence.

Our results favoring general interest interpretations of aid allocation are robust to an alternative operational definition of economic distress. Particularly, we find that firms' total liabilities (debt) have a negative effect on the decision to apply, but not on aid allocation. These results are in line with our theoretical priors: in economies with a history of poor financial discipline, arrears send strong negative signals about firms' reliability, so delinquent firms are discouraged from applying and are never given state aid. These results further substantiate our conclusions that aid allocation has targeted economically viable firms.⁵⁵

Although the countries in our sample are generally similar in the sectoral composition of their economies, political leaders may have different beliefs about which sectors are strategically important and worthy of support.⁵⁶ To account for the possibility that sectoral effects vary by country, we create additional

⁵⁴ We also find evidence of the interaction effect between firm's capacity utilization and average performance in firm's sector. We cannot distinguish, however, whether this is motivated by the politicians' concerns for the general economy, or by these firms' better lobbying capacity. Regression analysis results are available from the authors upon request.

⁵⁵ Results are in the Appendix, Table 4.

⁵⁶ According to the 2014 World Development Indicators, for these 6 countries between 52 and 75 percent of GDP is from the service sector and less than 10 percent comes from agriculture (World Development Indicators 2014. Washington, DC: World Bank). No country in our sample has a large extractive economy (as in Russia), and none is marked by reliance on a single commodity.

variables, which encompass the sector and the country. We find that in fact there are country-specific sectoral differences.⁵⁷ After we control for country-level industry association membership rates, extractive industry dummies are negative for all countries in the sample. Bulgarian manufacturing firms were more likely to receive aid, while Hungarian manufacturing sector was less likely to be rewarded with aid. One possible interpretation of these differences is that industries suffered greater losses in some countries than others, making politicians prioritize some sectors over others.⁵⁸ Unfortunately, with firm level data from only 6 countries we are unable to fully investigate sectoral dimensions of aid allocation. Sector-level analysis with larger cross-sectional or time-series span would be more appropriate to tackle this issue. It is worth noting, however, that our main firm-level results (with a sole exception of firm size that is highly correlated with sector) are robust to the introduction of county-sector dummies.

In summary, we find that politicians' decisions about state intervention are not dictated by firms' lobbying capacity and influence, but rather are shaped by considerations about aggregate economic performance. Our analysis generally supports the expectation that aid allocation targeted firms in good economic standing that otherwise might have had poor access to financing.

6 Conclusion

Previous research has stressed the prevalence of politically motivated anti-crisis policies that cater to special interests.⁵⁹ Orlov observed the limited economic effectiveness of government assistance: although some government subsidies to troubled Russian companies promoted economic restructuring, for the most part government assistance from 1996 to 1998 benefited economically inefficient but politically influential companies.⁶⁰ Faccio found that politically connected firms are not only more likely to be helped, but also tend to exhibit worse economic performance prior to and following bailouts; such effects were found to worsen when international financial institutions lent financial resources to domestic governments.⁶¹

⁵⁷ See Appendix, Table 4 for full results.

⁵⁸ We find some indirect evidence of this by observing that firms in sectors with poor average performance were more likely to apply for state aid. We utilize the information of average growth/decline of sales reported by firms in 18 economic sectors to compute the sectoral measure of performance. Results are available from the authors.

⁵⁹ Keefer (2007).

⁶⁰ Orlov (2000).

⁶¹ Faccio, Masulis, and McConnell (2006).

Unlike previous research emphasizing interest groups politics as the source of aid decisions, we found no evidence that firms that are structurally important or are the largest players in their respective sectors are more successful in obtaining state aid. In other words, governments were not being swayed by what are often considered special interests. Additionally, politicians did not favor firms that employed the most workers. Instead, we find evidence that politicians were favoring small and dynamic firms in temporary need of assistance and firms in small towns. Our confidence in these findings is bolstered by the fact that the estimates account for which types of firms were most likely to apply. This allows us to rule out potential counter-arguments about which firms might be likely to seek assistance in the first place. Furthermore, we offer an important contribution by using micro-level data in a literature that has generally relied on aggregate level findings regarding when politicians favor particular firms.

Our findings suggest that politicians are somewhat akin to doctors using a kind of triage logic in battle. Doctors may choose to first help those with the greatest chance of survival leaving the worst wounded for later assistance.⁶² In our case, politicians are reasoning that small firms are more likely to benefit from their short-term assistance while large firms may be too far gone or need too much help to survive and help with the general economic recovery. The key distinction we draw is between particular and collective social interests

The triage logic definitely does not serve the largest number of particularistic interests, but given limited resources, it might be the best – albeit not the fairest – way to serve the collective interests of economic recovery. This is consistent with recent work showing that politicians in democracies care a great deal about the average citizens' consumer preferences.⁶³ Given the evidence presented here, we cannot think of an equally plausible alternative explanation for why politicians would favor small dynamic firms over larger firms that employ more people.

Our assessment stands in contrast to conventional accounts of state assistance with their overwhelming emphasis on large wealthy firms. Johnson, for instance, highlight the role played by just 13 influential bankers in the design of the American bailout program.⁶⁴ In a similar vein, Woll examines variation in large bank bailouts in 6 OECD countries concluding that banks were generally better off when their collective inaction forced a piecemeal approach by legislators.⁶⁵

⁶² We thank an anonymous reviewer for suggesting this analogy.

⁶³ Baker, *The Market and the Masses in Latin America*; see also the working paper by Andy Baker and Stefan Wojcik, "Are Democracies Cheaper for Consumers? Regime Type, Prices, and the Consumer Producer Tradeoff," presented at the University of Colorado, Boulder, March 2015.

⁶⁴ Johnson and Kwak (2010).

⁶⁵ Woll (2014), *The Power of Inaction: Bank Bailouts in Comparison*.

Such accounts lend important insight into the political role of large and powerful firms and why the influence of large firms varies across countries, but overlook the very important political story surrounding the majority of businesses that are small or medium-sized.

What might explain the lack of support for the special interest politics in state aid distribution in these 6 countries? We speculate that the answer lies in the political incentives created by financial crisis and the structure of domestic and external (primarily EU) political constraints on state actors. The EU provided guidelines about what types of aid could be offered and prevented some types of favoritism. As we note, however, even within the EU guidelines, governments had significant discretion about which firms could get aid, and firms of all types were often eligible to apply for aid. Furthermore, EU regulations do not dictate that politicians cannot favor particular sectors or large firms. In other words, politicians could favor particular interest groups even within EU guidelines. Thus, we conclude that financial crisis motivates politicians to concern themselves with collective social interests instead of pandering to certain subsets of society.

Our findings are consistent with recent arguments that our understanding of business influence must be more nuanced. Culpepper, for instance, argues that businesses and the state are mutually dependent on each other and in ways that create advantages for certain businesses or state actors in some contexts but not others.⁶⁶ We must be careful to interpret structural power correctly rather than assuming that businesses always enjoy a privileged position. Fairfield highlights this point by noting that business influence can be mitigated by electoral incentives and popular mobilization.⁶⁷ In our case, electoral incentives also play a central role in explaining why politicians favored small, dynamic firms over the larger and more traditionally influential ones. Businesses may enjoy some advantages in exerting political influence due to their structural position in the economy, but our research builds on existing work to show that how, when, and which businesses are the most influential varies tremendously.

Appendix

Here we check whether our results are robust to alternative ways of modeling the effects of firm characteristics and country-level conditions on the outcome

⁶⁶ Culpepper (2015).

⁶⁷ Fairfield (2015).

of state aid allocation. We estimate two different specifications of Heckman Probit (sample selection) models. We first treat firms' access to internal finance as a censoring variable.⁶⁸ This specification is motivated by theoretical considerations. In the absence of its own investment capital, a firm has stronger incentives to apply for state aid. The availability of a company's internal capital, however, should not prevent state decision-makers from allocating aid regardless of whether they follow a logic of aid allocation based on special interests or general economic concerns. Our second specification uses country-level controls as censoring variables that affect a firm's decisions to apply for state aid, but not the governments' decisions to honor these requests. The theoretical expectation is that for any given government, the country-level considerations remain constant across all firms, and therefore should not be important for making firm-specific aid decisions.

The Heckman model is best suited for situations in which we believe the selection and outcome models are not independent. In fact, statistics reported at the bottom of Table 5 fail to reject the hypothesis that $\rho=0$, meaning that the selection and outcome models have correlated errors and are not independent. We proceed to the interpretation of two Heckman selection models reported in Columns 1 through 4, Table 5. The coefficients in the selection regressions look very similar to those produced by the Binomial Probit models. The outcome coefficients for the key explanatory variables are also in the same direction and of comparable magnitude as those produced by the Binomial Probit estimates. The major difference between the fully specified Binomial Probit and the second Heckman Probit specification is the disappearance of the negative effect of internal financing in the outcome equation (the effects remain unchanged in the selection equation). Additionally, a firm's location does not have consistent effects across different model specifications. Firm location loses its effect as a predictor of aid allocation (but not application). The substantive effects of the small firm size and good performance, however, are robust to the specification of the sample selection model, while firms' market shares, access to foreign markets, and sectoral locations remain insignificant in predicting aid allocation. This generally confirms our conclusion that European state aid allocation targeted small firms with strong growth potentials, which is most consistent with the general concerns for economic recovery.

68 Although technically Heckman models are identified with exactly the same regressors included in the selection and outcome equations, we follow the advice of Anna Sartori. "An Estimator for Some Binary-Outcome Selection Models Without Exclusion Restrictions." In: *Political Analysis* 11 (2003), 111138, who recommends that at least one censoring variable be excluded from the outcome equation.

Table 4: Baseline models and additional analyses.

	Time fixed effects logit clust. SE	Receive	Aid	Country fixed effects logit clust. SE			
				Probit (Panel Clustered SE)		Binomial Probit (Panel Clustered SE)	
				Apply	Receive	Apply	Receive
Full-time employment	-0.069 (0.049)	-0.072 (0.049)	-0.034 (0.006)***	0.001 (0.015)	-0.007 (0.007)	0.008 (0.010)	-0.014 (0.007)*
100 permanent employees	0.008 (0.003)**	0.008 (0.003)**	0.005 (0.001)***	0.001 (0.001)	0.005 (0.001)***	-0.003 (0.002)	0.002 (0.002)
Firm performance	-0.002 (0.004)	-0.002 (0.004)	-0.0008 (0.002)	-0.0004 (0.002)	-0.001 (0.001)	-0.003 (0.002)	-0.003 (0.002)
Capacity utilization, %	0.053 (0.115)	0.083 (0.116)	0.006 (0.036)	0.005 (0.034)	-0.020 (0.044)		
Market share							
% Corresponding market							
Business growth							
Sales change							
Total liabilities							
1,000,000 Euro							
Internal financing	-0.007 (0.003)**	-0.006 (0.002)**	-0.003 (0.0008)***	-0.004 (0.0006)***	-0.004 (0.001)***	-0.002 (0.001)***	-0.002 (0.001)*
Share of operating costs	-0.0008 (0.005)	-0.0008 (0.005)	-0.0007 (0.001)	-0.00009 (0.001)	-0.0009 (0.001)	-0.001 (0.001)	-0.002 (0.001)*
Direct exports	0.399 (0.256)	0.402 (0.254)				0.483	0.554
Share of firm's sales	0.155 (0.584)	0.147 (0.582)				(0.109)***	(0.150)***
Secondary sector	-0.003 (0.004)		-0.002 (0.002)	-0.003 (0.001)***	-0.002 (0.002)	0.483 (0.244)*	0.535 (0.160)***
Sector dummy	1.504 (102.648)		0.027 (0.020)	0.032 (0.017)*	0.009 (0.040)		
Extractive industry							
Sector dummy							
Firm location							
City population, 100,000 res.							
Δ GDP							
Annual growth rate, t-1							

Table 4 (continued)

	Time fixed effects logit clust. SE	Receive	Aid	Country fixed effects logit clust. SE			
				Probit (Panel Clustered SE)		Binomial Probit (Panel Clustered SE)	
				Apply	Receive	Apply	Receive
Government budget	-5.272		-0.170	-0.156	-0.187		
Balance t-1	(246.262)		(0.043)***	(0.043)***	(0.055)***		
Business organizations			0.026	0.019	0.029		
Membership, % firms			(0.005)***	(0.004)***	(0.009)***		
Turkey secondary			0.115	0.202	0.113		
Sector dummy			(0.138)	(0.180)	(0.143)		
Romania secondary			0.161	-0.010	0.037		
Sector dummy			(0.214)	(0.194)	(0.322)		
Hungary secondary			†	-0.023	-6.476		
Sector dummy				(0.133)	(0.193)***		
Latvia secondary			0.269	-0.214	0.183		
Sector dummy			(0.226)	(0.182)	(0.439)		
Lithuania secondary			0.042	-0.187	0.006		
Sector dummy			(0.108)	(0.092)**	(0.111)		
Bulgaria secondary			1.389	1.063	1.375		
Sector dummy			(0.309)***	(0.237)***	(0.314)***		
Turkey extractive			0.036	0.163	-0.008		
Sector dummy			(0.139)	(0.186)	(0.130)		
Romania extractive	†-7.046	-6.800					
Sector dummy	(0.162)***				(0.162)***		
Hungary extractive	†-6.411	-6.156					
Sector dummy	(0.246)***				(0.222)***		

Table 4 (continued)

	Time fixed effects logit clust. SE	Receive	Aid	Country fixed effects logit clust. SE				
				Probit (Panel Clustered SE)		Binomial Probit (Panel Clustered SE)		
				Apply	Receive	Apply	Receive	
Latvia extractive Sector dummy	t-7.031 (0.136)***							
Lithuania extractive Sector dummy			t-7.130				(0.147)***	
Bulgaria extractive Sector dummy			t-6.122				(0.170)***	
Constant							(0.332)***	
							-4.823	
							(0.755)***	
							-1.249	
							(0.336)***	
Obs.	3137	3137	2925	3137	3137	2488	2488	2488

***p<0.001, **p<0.01, *p<0.05, †dropped due to perfect collinearity.

Table 5: Probit model with sample selection (Heckman Model).

	(1)		(2)	
	Apply	Receive	Apply	Receive
Full-time employment	0.0007	-0.046	0.0006	-0.043
100 permanent employees	(0.015)	(0.023)*	(0.015)	(0.024)*
Firm performance	0.0008	0.010	0.0008	0.009
Capacity utilization, %	(0.0013)	(0.003)***	(0.001)	(0.003)***
Market Share	-0.0006	-0.002	-0.0005	-0.001
% Corresponding product/service market	(0.002)	(0.003)	(0.002)	(0.003)
Business growth	0.011	-0.043	0.010	-0.043
Sales increased=1, same=0, decreased=-1	(0.032)	(0.044)	(0.039)	(0.036)
Internal financing	-0.003		-0.003	0.001
Share of operating costs	(0.0007)***		(0.0006)***	(0.002)
Direct exports	0.0002	-0.003	0.0002	-0.003
Share of firm's sales	(0.001)	(0.004)	(0.0007)	(0.004)
Secondary sector	0.106	0.276	0.107	0.211
Sector dummy	(0.099)	(0.255)	(0.068)	(0.234)
Extractive Industry	0.018	-0.057	0.019	-0.080
Sector dummy	(0.103)	(0.224)	(0.089)	(0.216)
Firm Location	-0.003	0.002	-0.003	0.003
City population, 100,000 residents	(0.001)***	(0.003)	(0.0008)**	(0.002)
Government budget balance	-0.116	-0.062	-0.116	
t-1	(0.045)**	(0.150)	(0.045)**	
Δ GDP	0.031	-0.062	0.030	
Annual growth rate, t-1	(0.018)	(0.103)	(0.017)*	
Business organizations' strength	0.019	0.020	0.019	
Membership in business organizations, % firms	(0.005)***	(0.026)	(0.005)***	
Constant	-3.364	-1.582	-3.368	0.549

Table 5 (continued)

	(1)		(2)	
	Apply	Receive	Apply	Receive
Log pseudolikelihood	(0.569)***	(3.524)	(0.575)***	(0.544)
Obs.		-761.351		-761.810
ρ		3137		3137
		-0.037		-0.437
Wald ($\rho=0$) χ^2		(0.686)		(0.261)
Prob. χ^2		0.001		2.10
		0.957		0.147

Country-clustered robust standard errors in parentheses.

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

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