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The effect of political representation on the geographic distribution of income: Evidence using Belgian data

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ABSTRACT

This paper investigates the role of political representation in explaining geographical variation in social security and income tax transfers. To quantify the causal link going from political representation to transfers, we identify two sets of exogenous changes in political representation and use an instrumental variable approach. Using Belgian data for the 1995–2010 period, we find that transfers to inhabitants of a particular electoral district increase significantly with every extra federal minister originating from that electoral district. Given that social security and income tax transfers appear to be largely formula-based this result is surprising.

1. Introduction

This paper investigates the role of political representation in explaining geographical variation in social security and income tax transfers. For many countries there exists scientific evidence of political manoeuvring in allocating *discretionary* expenditures geographically (see e.g. Dahlberg and Johansson (2002) for Sweden and Knight (2008) for the US). However, in this paper we look at the geographical distribution of the income tax, social security contributions and social expenditures, which are firmly based on legislation, and therefore — presumably- *formula-based*. The social expenditures we consider comprise all major social transfer categories: pensions, unemployment benefits, child allowances, work disability allowances, allowances for the handicapped, and subsistence allowances. In 2010, income taxes on average amounted to 8.4% of GDP in OECD countries, while social security contributions on average amounted to 10.1% of gross wage earnings, and social expenditures on average amounted to 22.1% of GDP.[1] The fiscal transfers we consider are clearly economically very meaningful in size, but have nevertheless received little attention in previous research, perhaps because they are thought to be mainly formula based and therefore mostly immune to tactical manipulation.

Tax and social security systems may be less formula-based than they appear at first sight, however. Firstly, politicians may cater to their constituency by introducing and changing legislation. One example would be the creation of target group measures in social security (e.g. employment schemes and rebates in social security contributions) and in the tax system (e.g. targeted tax rebates). These types of measures are an important element of social security and taxation systems in most countries. Secondly, even within apparently formula-based systems such as social security, some decisions remain discretionary. An example for Belgium is the fact that the

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[1] See www.oecd.org.

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agreement of the federal minister of employment is required to secure exceptional state-funded early retirement for employees of any firm that has gone out of business. Thirdly, the practical implementation of legislation might be influenced. Politicians may prod local branches of the tax and social security administrations towards lenient taxation and social security audits. In Belgium, considerable geographical disparity in the number of tax and social security audits has been found to exist (Deloitte, 2010). Lastly, the practical organisation of the executive in most countries involves regular meetings between ministers, offering plenty of scope for negotiation and bargaining such that a minister with competencies unrelated to tax or social matters can nevertheless weigh in on decisions related to these topics affecting his/her constituency. It is important to keep in mind that although we believe that the above channels may be at work and could at least partially offer an explanation of the empirical regularities we observe, our results below do not constitute proof of any of these channels in particular to be operative.

Motivated by the fact that in most countries the executive dominates the legislative, the focus of our attention will be on political representation within the executive power. This stands in contrast with the bulk of the distributive politics literature where the focus has been on parliamentary representation. To identify causal effects of political representation on transfers we perform an instrumental variable analysis using a Belgian dataset for the years 1995–2010. A first approach we use is to exploit the resignation of ministers following various events deemed orthogonal to transfers. In a second and separate IV analysis, we exploit the unique opportunity offered by the changes in ministerial representation which occurred due to the redrawing of the Belgian electoral district borders in the reform of 2002.

The remainder of this paper is structured as follows. Section 2 gives an overview of the distributive politics literature in the context of which our paper is to be situated. Section 3 describes the data we use in our analysis. Section 4 consists of the actual empirical analysis of social and fiscal transfers and the quantification of the effect of ministerial representation. Section 5 draws a number of conclusions.

2. Related literature

Our analysis differs from the mainstream distributive politics literature because of the combination of our choice of the independent variable of interest (political representation in the executive), the dependent variable we consider (formula based transfers), and our empirical strategy (using instrumental variables to control for reverse causality). In the following paragraphs we discuss these three differences in detail.

2.1. Political representation in the executive versus in the legislative

The bulk of the literature on the effect of political representation on fiscal transfers has so far focused on districts' representation within the legislative, rather than within the executive. Within this literature, most research has focussed on representation within US Congress. Some of this literature looks at districts' representation in Congress across-the-board, i.e. without distinguishing if a district is represented by a Congress member belonging to the majority or not. An example is the research by Ansolabehere et al. (2002, 2003) on the effects of representation of districts compared to their population size. Examples for Canada are Evans (2005) and Jutras and Vaillancourt (2008). Dragu and Rodden (2011) perform a cross-country study on the effects of representation of districts compared to their population size in federations over the world.

A number of studies explicitly consider the effect of whether a district voted in favour of the majority in the US Congress on transfers received. Examples are Albouy (2013) and Young and Sobel (2013). Guccio and Mazza (2014) take a similar perspective for a region of a European country, i.e. Sicily. Studying different countries, Bickers and Stein (1996), Dahlberg and Johansson (2002), and Helland and Sørensen (2009) focus on the narrowness of the vote margin by which the parliamentary majority “holds” a particular district. The latter studies find that so called “swing districts”, i.e. districts represented by vulnerable seats, receive more transfers.

However, in many countries, the legislative is dominated by the executive –and in particular by cabinet ministers – as well as by political parties and their presidents (see e.g. Timmermans, 1994 and Dewachter, 2001 for case studies of Belgium). The role of political parties in determining transfers is more closely investigated by a series of studies that analyse the effect of political alignment. More in particular, these studies investigate if more transfers result from similarity between the district's lower level government and the transfer providing higher level government with respect to their party-political composition. Examples of studies of such alignment effects are Brollo and Nannicini (2012) for Brazil and Migueis (2013) for Portugal.

It is surprising that only three papers in the distributive politics literature investigate the effect of district representation by one or more individual members of the executive, i.e. by cabinet ministers on transfers.[2] Crampton (2004) and Milligan and Smart (2005) do so for Canada. Both find that swing districts held by a minister receive more grants, and also –but to a lesser extent – that the governing party's swing districts in general receive more grants. This extra support goes at the expense of the governing party's core districts. Similarly, Golden and Picci (2008) find for Italy that ministers' districts[3] receive more grants at the expense of the governing parties' core districts.

Given the political predominance of the executive in many countries, we will focus on the geographical distribution of government ministers when looking for a political explanation of the geographical distribution of fiscal transfers in our empirical application to the case of Belgium.

[2] However, some US studies distinguish between political representation as such and representation by particularly powerful members of a political party. Examples are Knight (2005, 2008), who investigate the effect of proposal power that some members of Congress have thanks to their membership of Congress committees whose expenditure impact is large.

[3] As well as districts of other powerful party members, such as party presidents.