

Ingmar J. Schustereder

Welfare State Change in Leading OECD Countries

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Ingmar J. Schustereder

Welfare State Change in Leading OECD Countries

The Influence of Post-Industrial
and Global Economic Developments

With a foreword by Prof. Dr. Joachim Ahrens



RESEARCH

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Foreword

For many years, academics and practitioners in economics as well as political science have been engaged in a controversial discussion about the driving forces behind the emergence, change, and reform of modern welfare states. This study aims at enhancing our understanding of institutional, structural, and political adjustment processes in advanced capitalist welfare states. This is being investigated against the background of globalization processes of labor, capital, and goods markets, on the one hand, and post-industrial developments within nation states as outlined by Pierson (2001a) (such as population ageing, de-industrialization, changing household structures, rising unemployment) on the other hand. The key research objective is to analyze the processes of the recent past between 1975 and 2000. In particular, the author addresses two research questions: (1) what is the relative influence of post-industrial and globally economic forces, respectively, with respect to recent changes of welfare states?, and (2) to what extent could different national systems of social security maintain their institutional core characteristics over time? Addressing these questions is not only of great relevance from an economic point of view, but also highlights the enormous political importance. Eventually, the question takes center stage in how far specific national regulatory systems are viable in times of globalization and to what extent national governments are still capable of acting independently regarding the creation and reform of institutions.

Ingmar Schustereder argues that countries adjust in different ways to these challenges. Although all welfare states have been under adjustment pressure, some nations appear to be better able than others to confront these contemporary challenges. Based on an in-depth discussion of different theoretical approaches, the author applies both sophisticated quantitative and qualitative techniques to shed light on these different adjustment strategies.

This investigation at the interface of economics, political science, and sociology represents, without doubt, an outstanding piece of research. From a theoretical perspective, the author provides a concise and yet differentiated survey of all relevant approaches, which are applied in an intellectually stimulating way. The subsequent empirical analysis is based on a broad range of variables, applies pooled cross-section time series models, and is complemented by illustrative case studies.

This balanced, theoretically well-grounded, and empirically convincing analysis will benefit a wide range of readers in the academic as well as in the policy-making community. It significantly contributes to a better understanding of changes in contemporary welfare states. Most important new insights relate to the realms of comparative empirical welfare state research, the research of globalization processes, and the so-called varieties-of-capitalism approach.

Acknowledgement

Conceptualizing and writing the dissertation at hand has been both a challenging and interesting experience for me. Along this academic journey, many people have accompanied me to whom I am very grateful. In particular, I would like to thank my Doktorvater Prof. Dr. Joachim Ahrens for valuable advice and guidance. I am also indebted to Prof. Dr. André Schmidt for taking on the role as second supervisor upon the unfortunate death of Prof. Dr. Rolf Caspers. Without them, the completion of this dissertation would not have been possible.

During the course of my research, I have gained important insights from my classmates in the Advanced Studies Program 2005/ 2006 at the Kiel Institute for the World Economy, researchers at the Department of Political and Social Sciences at Pompeu Fabra University, and participants of the Oslo Summer School in Comparative Social Science Studies. To them I give my deepest appreciation. Furthermore, I would like to thank Dipl.-Kfm. Robert Esser, Dipl.-Vw. Christian Gäckle, Dipl.-Ing. Stephan Salinger, Mag. Dr. Sandra Stötzer, and Dipl.-Ök. Dr. Dennis Stremmel for their moral support.

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Ingmar Josef Schustereder

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List of Abbreviations

AR (1)	First-Order Autocorrelation
BIS	Bank for International Settlements
EPL	Employment Protection Legislation
FDI	Foreign Direct Investment
FX system	Fixed Exchange-Rate System
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
ITO	International Trade Organization
MNCs	Multinational Corporations
MR	Multiple Regression
NGOs	Non-Governmental Organizations
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
PCSE	Panel Corrected Standard Errors
PSEX	Public Social Expenditures as percentage of GDP
SSTRAN	Social Security Transfers as percentage of GDP
SWFs	Sovereign Wealth Funds
TSCS	Time-Series Cross-Section
UK	United Kingdom
US/ USA	United States
TNCs	Transnational Corporations
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
VoC	Varieties of Capitalism
vs	versus
WDI	World Bank Development Indicators Database
WTO	World Trade Organisation
WWI	First World War
WWII	Second World War

1 Introduction

1.1 Research Scope

Ever since the introduction of social insurance legislation beginning in the last decades of the 19th century, social scientists have been interested in analyzing the causal forces behind the development of the modern welfare state. Precisely, for most of the period the academic debate has hereby mainly centered on the following questions: Why was the welfare state founded in the first place? And which factors have contributed to its rapid expansion in the aftermath of World War Two (WWII)?¹

With the advanced capitalist welfare states beginning to face increasing challenges from the mid-1970s onwards, academic research has recently shifted from providing explanations on the rise of the welfare state to understanding processes of welfare state adaptation. In general, advanced capitalist welfare states confront today two types of challenges: on the one hand, pressures from post-industrial developments, and on the other hand, pressures from global economic forces (see Buti, Franco, and Pench, 1998, pp. 17-26). Following Pierson (2001a), the most severe “post-industrial pressures” (p. 80) involve ongoing processes of deindustrialization, population ageing, changing household structures, and welfare state maturation (pp. 82-83). Apart from these domestic challenges, advanced capitalist welfare states have recently also been affected by developments occurring in the global sphere. While processes of international economic integration had already resumed in the immediate aftermath of WWII, they have significantly intensified during the last four decades. Besides the gradual lifting of impediments to international trade, the emergence of multinational corporations (MNCs) and the deregulation of financial markets (following the liberalization of the exchange rate system in the early 1970s) have in particular contributed to the growing interdependence of nation states (see OECD, 2005a, p. 16). Although global economic forces appear to shape social policy, their intensity and direction are still under debate (for an overview of theories on the globalization-welfare state nexus, see Chapter 1.2).

In light of rising challenges both in the domestic and global realm, the aim of this dissertation is to analyze the recent development process of advanced capitalist welfare states. Precisely, the author will focus on the following two research questions: Firstly, what has been the relative influence of post-industrial and global economic developments on recent welfare state change? And secondly, to what extent have different national systems of social protection preserved their core institutional features?

¹ For a thorough review of political economic theories on the rise of the welfare state, see Esping-Andersen (1990/ 1998, Chapter 1) and Chapter 2.2 in this dissertation.

1.2 Theoretical Framework

Taking a holistic approach, the author tests various theories on the driving forces behind the contemporary advanced capitalist welfare state. Partly in line with recent categorizations by a number of scholars (for example, Brady, Beckfield, and Seeleib-Kaiser, 2005, pp. 922-925; Brady, Beckfield, and Zhao, 2007, pp. 318-320; Ellison, 2006, pp. 48-59; Genschel, 2004; Hicks, 1999, pp. 157-168, Chapter 7; Koster, 2008, pp. 2-3; Swank, 2002/ 2004, 20-58), the author hereby classifies the theories into three broad schools of thought:

Proponents of the first school of thought (for example, Castles, 2001; Iversen, 2001; Iversen & Cusack, 2000; Pierson, 2001a; Pierson, 1996; Pierson, 1994/ 1997) downplay the role of global economic forces, suggesting instead that domestic factors are by far more important drivers of contemporary welfare state development. Precisely, deindustrialization, population ageing, household structure transformation, and welfare state maturation are considered to be the key challenges of social policy (see Pierson, 2001a). As awareness of these domestic pressures has significantly grown in recent decades, an intense debate has erupted about the potential implications these post-industrial developments are likely to have for the process of political decision-making. Social scientists in comparative welfare state research, affiliated with the *power resources* approach and the *class mobilization* thesis² (such as Allan & Scruggs, 2004; Castles, 1982; Esping-Andersen, 1985/ 1988; Garrett, 1998a; Huber & Stephens, 2000; Korpi, 1989; Korpi, 1980; Korpi & Palme, 2003), are of the opinion “that it is fruitful to view welfare states as outcomes of, and arenas for, conflicts between class-related, socioeconomic interest groups and that in these distributive conflicts partisan politics is likely to matter” (Korpi & Palme, 2003, p. 425). Recently, this view has been challenged by the emergence of the *new politics* approach which states that political parties and labor organizations have ceded power to pro-welfare state oriented interest groups (mainly welfare state employees and recipients) within the social policy context (Pierson, 1996, p. 147; see also Pierson, 1994/ 1997, 2001b, 2001c).³

In contrast to the prior academic camp, the second school of thought – the so-called *Openness Literature* – places global economic forces at the core of recent processes of welfare state change. Precisely, this strand of literature revolves around the following three perspectives: the *competitiveness view*, the *compensation view*, and the *curvilinear view* (see Hicks, 1999, pp. 204-208; Brady et al., 2005, pp. 922-924). According to the competitiveness view, economic globalization – fostering

² See Chapter 2.2 for a detailed explanation of these theoretical concepts.

³ A detailed analysis of the post-industrial challenges and their potential implications for the political decision-making process is provided in Chapter 5.

locational competition between nation states to attract mobile production factors (Siebert, 1999/ 2000, p. 241) – entails a decline in state capacity (Cerny, 1994, p. 334) and a simultaneous erosion of the post-WWII welfare state (Sinn, 2003, pp. 64-65; see Razin & Sadka, 2005, p. 4, 35-36; Sinn, 2001, pp. 13-15). By contrast, proponents of the compensation view assume that economic globalization induces a rise in public social spending since citizens need to be protected from the fluctuations of global markets (see Cameron, 1978, pp. 1255-1258, 1260; Hicks & Swank, 1992, pp. 666-667; Katzenstein, 1985, p. 9, 24; Ruggie, 1982, pp. 392-393, 399). Finally, the curvilinear view combines the compensation and the competitiveness view in a sequential order. Accordingly, the process of international economic integration is at first accompanied by a gradual augmentation of public transfer programs; however, beyond a certain level of international capital openness, welfare spending is cut in order to reduce the tax burden on mobile production factors since the latter would otherwise escape from the country thereby undermining the welfare state's fiscal stance (Rodrik, 1997, pp. 89-90; Hicks, 1999, pp. 206-211).⁴

The third school of thought – the so-called *context-contingent view*⁵ or “‘weak globalization’ thesis” (Ellison, 2006, p. 48) – acknowledges that global economic processes have been augmenting in intensity; it nevertheless claims that the direction and force of these globalization effects on national systems of social protection are shaped by respective countries' institutional context. Consequently, adjustment strategies – being influenced by *path dependency* – are assumed to vary leaving the general diversity of existing welfare state clusters more or less unchanged (Bonoli & Palier, 2001, p. 58; Ellison, 2006, pp. 48-49; Leibfried & Obinger, 2001, p. 5; Scharpf, 2000, p. 224; Swank, 2003, pp. 60-61; Swank, 2002/ 2004, p. 5).⁶

1.3 Methodology

Throughout the dissertation, a three-step methodological approach is applied. In the first step, the author conducts a comprehensive classification of 17 leading welfare economies. Relying to a great extent on Esping-Andersen's (1990/ 1998, 2000) welfare state regime indicators, each welfare state is assessed according to the level of de-commodification, the modes of social stratification, and the degree of de-familialization. Subsequently, in line with Hall & Soskice's (2001/ 2004a, 2001/ 2004b) *Varieties of Capitalism* (VoC) approach, the production side of the 17 welfare economies

⁴ A detailed presentation of the Openness Literature is provided in Chapter 6.3.1.

⁵ The author coined this term to best describe the essence of the literature on globalization and varieties of welfare capitalism.

⁶ A detailed presentation of the context-contingent view is provided in Chapter 6.3.2.

is evaluated. Following these comparative analyses, the author examines the recent development of post-industrial challenges and global economic forces.

The second and third methodological step comprise in-depth empirical analyses to test all prevailing theories on the driving forces behind the contemporary advanced capitalist welfare state. Similar to prior studies in this field of research (for example, Huber & Stephens, 2001a; Swank, 2002/ 2004), the author pursues a hybrid approach consisting of quantitative and qualitative analyses (“triangulation”⁷). With respect to the quantitative analysis (second methodological step), a set of various pooled cross-section time series models is applied. The dataset hereby includes the 17 welfare economies for the time period 1975-2000. Brady et al.’s (2005) model provides a basis for the econometric analysis because it takes a truly holistic approach to testing all of the major theoretical hypotheses on the determinants of public social spending in OECD countries.⁸ In order to make the results of this quantitative study comparable with their earlier findings, the author has opted to use to a certain extent a similar dataset for the explanatory variables as well as the welfare state measures. Moreover, with respect to model operationalizations, the author follows Brady et al. (2005) in relying to a great extent on Huber & Stephens (2001a, 2000) prior works.

Although the econometric analysis is built on previous academic studies, it also addresses a number of limitations of past research. Specifically, the following contributions are made to contemporary comparative welfare state research: Firstly, to the best of the author’s knowledge, this quantitative study is one of the first of its kind to link the VoC and the Three Worlds of Welfare Capitalism approach in a comprehensive econometric analysis for the recent period. While Brady et al. (2005) conduct a series of sensitivity analyses for liberal/ non-liberal as well as European/ non-European welfare states (pp. 940-943), the author constructs a series of interaction models that simultaneously control for liberal, conservative, and social-democratic welfare state regime clusters. In this context, it should be noted that Swank (2002/ 2004) has already run regression analyses for each of the three welfare state clusters. The dataset of Swank (2002/ 2004) however includes only the time period 1965-1993 (pp. 103-121). Recently, Kim & Zurlo (2008) have conducted a similar comparative study using a dataset from 1980-2001.

Secondly, this quantitative study sheds light on the rapid decline of public social spending in the Nordic countries in the early 1990s. Using a structural break model, the author analyzes the hump-shaped pattern of public social spending in the social-democratic welfare regime cluster in detail.

⁷ According to Shalev (2007), “*triangulation* [...] means combining MR [Multiple Regression] with other types of analysis – quantitative, qualitative or both” (p. 296).

⁸ It should be noted that Brady et al. (2005) have heavily relied on Huber & Stephens (2001a, 2000) when constructing their own baseline model (p. 927).

Thirdly, with respect to the dependent variables, Scruggs' (2004a) Pension Generosity Index as well as the 2006 updated version of the de-commodification index, Scruggs' (2004a) Benefit Generosity Index, is applied. The use of both welfare state indicators not only circumvents the problems related to aggregate data, but should also clarify how welfare policy changes affect the individual life chances (see Allan & Scruggs, 2004, p. 498).⁹

Fourthly, the author uses both annual and cumulative political partisanship variables, but runs each model with only one of the four political partisanship variables (annual left, cumulative left, annual right, and cumulative right) at a time. By comparing annual and cumulative political partisanship models, the paper attempts to make a contribution to the ongoing debate about which measure is more appropriate for comparative welfare state research (see Hicks, 1999, pp. 189-193).

Fifthly and more generally, this quantitative study takes a slightly different modeling approach to Brady et al. (2005). Building an econometric model that controls for a multitude of different theoretical approaches, is a very difficult task since the author is compelled to construct a parsimonious while at the same time comprehensive model. While Brady et al. (2005) placed more emphasis on comprehensiveness this study aims to strike a balance between comprehensiveness and parsimoniousness. Starting with ten principal independent variables, the baseline model is then reduced to include only seven variables. Unlike in Brady et al.'s (2005) study, global economic forces are not categorized according to globalization advantage, openness, or threat (pp. 928-929); rather, they are related to the product (*Trade Openness* for international trade in goods and services) and factor (*FDI Openness* for international capital mobility and *Net Migration* for international migration) markets across which they tend to affect public social spending.¹⁰

Sixthly, in contrast to many previous studies in comparative political economy, this quantitative study takes possible nonstationarity issues in time-series cross-section (TSCS) analysis into account. Nonstationarity, if left untreated, can pose serious problems when interpreting the findings in pooled models (Kittel & Winner, 2005, p. 288). Due to recent developments in econometrics, this study tested for stationarity using the Levin-Lin-Chu panel unit root test (Levin, Lin, and Chu, 2002, pp. 2-3), a

⁹ For this reason, several scholars (for example, Allan & Scruggs, 2004; Brady et al., 2005; Fernandez, 2008; Korpi & Palme, 2003) have recently begun to use disaggregated welfare state measures.

¹⁰ Apart from differences in how to model globalization, the author has also not considered a number of domestic political and economic proxy variables which have been incorporated in Brady et al.'s (2005) earlier model. These variables include the following: Christian Democratic Cabinet, Union Density, Constitutional Structure, Female Labor Force Participation-Left Party Interaction Variable, Voter Turnout, Strikes, Authoritarian Legacy, GDP per Capita, Year, Military Spending, and Wage Coordination.

commonly used test for stationarity, available as a special coded program in STATA 9. According to Bornhorst & Baum (2001), “the test may be viewed as a pooled Dickey-Fuller test, or an Augmented Dickey-Fuller (ADF) test when lags are included, with the null hypothesis that of nonstationarity (I(1) behavior)” (n. p.).

Building on the insights of the quantitative study, the author conducts two types of qualitative analyses in the third methodological step. Partly following Ganghof (2000/ 2004), the focus of the first qualitative analysis is laid on the evolution of welfare state revenue flows in the 17 welfare economies during the period 1975-2005. Subsequently, in keeping partly with Swank (2002/ 2004, Chapter 4-6), the objective of the second qualitative analysis is to examine if the expenditure pattern and the underlying institutional configuration of the three welfare capitalist systems have changed in recent decades.

1.4 Course of Investigation

The dissertation is organized into three parts. Part I lays the theoretical foundations by making the reader familiar with the welfare state and the concept of *welfare capitalism*. Precisely, Chapter 2 defines the welfare state, gives an overview of its core functions and presents the principal political economic theories on the rise of the welfare state. Furthermore, adhering to Esping-Andersen’s (1990/ 1998, 2000) welfare state regime approach, existing variations between national systems of social protection are highlighted. In this context, a classification of 17 advanced capitalist welfare states is conducted.

Chapter 3 looks at the broader context of welfare capitalism by laying the focus on the welfare state-economy nexus. At first, the author gives a brief introduction into existing varieties of production regimes. A special focus is hereby laid on Hall & Soskice’s (2001/ 2004a, 2001/ 2004b) VoC approach. Subsequently, in line with Ebbinghaus & Manow (2001a, 2001b), linkages between the welfare state and three institutional domains of the economy (the system of industrial relations, the production system and employment regime, and the corporate governance and financial system) are analyzed. Finally, the chapter is rounded off with a classification of the production regimes of the 17 welfare economies.

Building on the theoretical foundations laid in Chapter 2 and 3, Part II of the dissertation brings into focus the contemporary challenges of advanced capitalist welfare states. Before analyzing these challenges, Chapter 4 reviews the historical process of welfare state development. Subsequently, adhering to Pierson’s (2001a) classification of “post-industrial pressures” (p. 80), Chapter 5 sketches the nature of welfare state challenges which are domestically provoked in the political and socio-economic realm. Precisely, the following post-industrial developments are hereby at

the core of the focus: deindustrialization, population ageing, household structure transformation, and welfare state maturation (see Pierson, 2001a). Finally, the author also analyzes the potential implications of these challenges for the political decision-making process.

Chapter 6 shifts the focus to welfare state challenges arising from economic globalization. For this reason, the author analyzes at first the causal forces behind the process of economic globalization. In this context, the development of international trade, financial and migration flows for the post-WWII era is examined. Subsequently, an overview of the principal theories on the welfare state-globalization nexus is presented.

Finally, Part III of the dissertation conducts in-depth empirical analyses in order to test all prevailing theories on the driving forces behind the contemporary advanced capitalist welfare state. Similar to prior studies (for example, Huber & Stephens, 2001a; Swank, 2002/ 2004), the author applies a hybrid approach comprising of quantitative and qualitative analyses. Given the complexity of methodological issues in comparative welfare capitalism research, Chapter 7 explains in detail why this empirical approach has been chosen. Subsequently, Chapter 8 presents various econometric models and their respective findings while Chapter 9 conducts a set of qualitative analyses shedding light on both the revenue and expenditure side of national systems of social protection in all three welfare state clusters. Finally, Chapter 10 summarizes the empirical findings and concludes the dissertation.

Part I

The Welfare State and Welfare Capitalism

Laying the theoretical foundations, Part I makes the reader familiar with the welfare state and the concept of welfare capitalism. Precisely, Chapter 2 defines the welfare state and gives an overview of its core functions. Furthermore, the author presents the principal political economic theories on the rise of the welfare state and classifies advanced capitalist welfare states according to Esping-Andersen's (1990/ 1998, 2000) welfare state regime approach. Subsequently, Chapter 3 looks at the broader context of welfare capitalism by focusing on the interrelationships between the welfare state and the economy.

2 Theoretical Foundations of the Welfare State

2.1 The Welfare State

2.1.1 Definition of the Terms *Welfare* and *Welfare State*

The term *welfare* defies clear-cut definition. Abstractly speaking, welfare may be defined as “the state of doing well especially in respect to good fortune, happiness, well-being, or prosperity” (Merriam-Webster, n.d.). Barr (2004) distinguishes between four different sources of individual welfare: Firstly, the labor market provides welfare in the form of wage income and occupational insurance schemes. Secondly, individual savings and private insurance contracts represent another source of welfare. Thirdly, individual welfare can also be derived through free or below-market-price services offered voluntarily by family members or others. Finally, the state also contributes to individual welfare in the form of cash benefits, benefits in kind, and subsidies (p. 6; Barr, 1992, pp. 742-743). Following Pierson’s (1998) schema, the first two categories are subsumed under *economic welfare*, the third category is defined as *social welfare*, and the fourth category falls under the rubric of *state welfare* (p. 6).

State welfare, commonly dubbed *the welfare state*, can be defined in various ways. According to a narrow definition, it involves two types of public welfare provision: cash benefits and benefits-in-kind (Barr, 2004, p. 7; Lindbeck, 2006, p. 2). According to Barr (2004), cash benefits consist of two principal components:

“1. *Social insurance* is awarded without an income or wealth test, generally on the basis of (a) previous contributions and (b) the occurrence of a specified contingency, such as becoming unemployed or reaching a specified age” (p. 7).

“2. *Non-contributory benefits* are of two sorts. So-called *universal benefits* are awarded on the basis of a specified contingency, without either contributions or an income test [(for example, child allowances)]. [...] *social assistance* is awarded on the basis of an income test. It is generally a benefit of last resort, designed to help individuals and families who are in poverty, whether as an exceptional emergency, or because they are not covered by social insurance, or as a supplement to social insurance” (p. 7).

Besides cash benefits, the second category of public welfare provision – benefits-in-kind – comprises the following services: education, health care, and various forms of care for children, handicapped, and senior citizens (Barr, 2004, p. 7; Lindbeck, 2006, p. 2). To summarize, Figure 1 (see p. 12) depicts the structure of the welfare state outlined above.

In a broader sense, the welfare state also involves, besides the two previously explained types of public welfare provision, “price regulation (such as rent control and agricultural price support), housing policies, regulation of the work environment,