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Welfare state transformation: Convergence and the rise of the supply side model

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TranState Working Papers

WELFARE STATE TRANSFORMATION:
CONVERGENCE AND THE RISE
OF THE SUPPLY SIDE MODEL

HERBERT OBINGER
PETER STARKE

No. 180

Universität Bremen • University of Bremen
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Staatlichkeit im Wandel • Transformations of the State
Sonderforschungsbereich 597 • Collaborative Research Center 597

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**Welfare State Transformation:
Convergence and the Rise of the Supply Side Model**

ABSTRACT

This paper describes welfare state transformation in OECD countries since the 1970s against the background of the post-war settlement. Relying on quantitative macro-data and qualitative information from the literature, we show that welfare states have converged, especially regarding various spending measures, and also to a certain extent in some qualitative policy-making patterns. What has emerged can best be described as the ‘supply-side welfare state’ model, and this overall orientation is reflected in many welfare state areas. We differ from earlier prognoses of a race to the bottom by generous welfare states and disagree with the view that a supply-side orientation equals ‘lean government’ in terms of social expenditure. But convergence implies that the space to maneuver has shrunk for policy-makers. The consequences of the 2008 financial crisis for welfare states are difficult to predict; short-term counter-cyclical measures in reaction to the crisis highlight the importance of protective buffers in highly integrated economies. Still, some countries have experienced harsh austerity measures since then, and thus the 2008 financial crisis may mark the end of the convergence period described here.

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Welfare State Transformation: Convergence and the Rise of the Supply Side Model

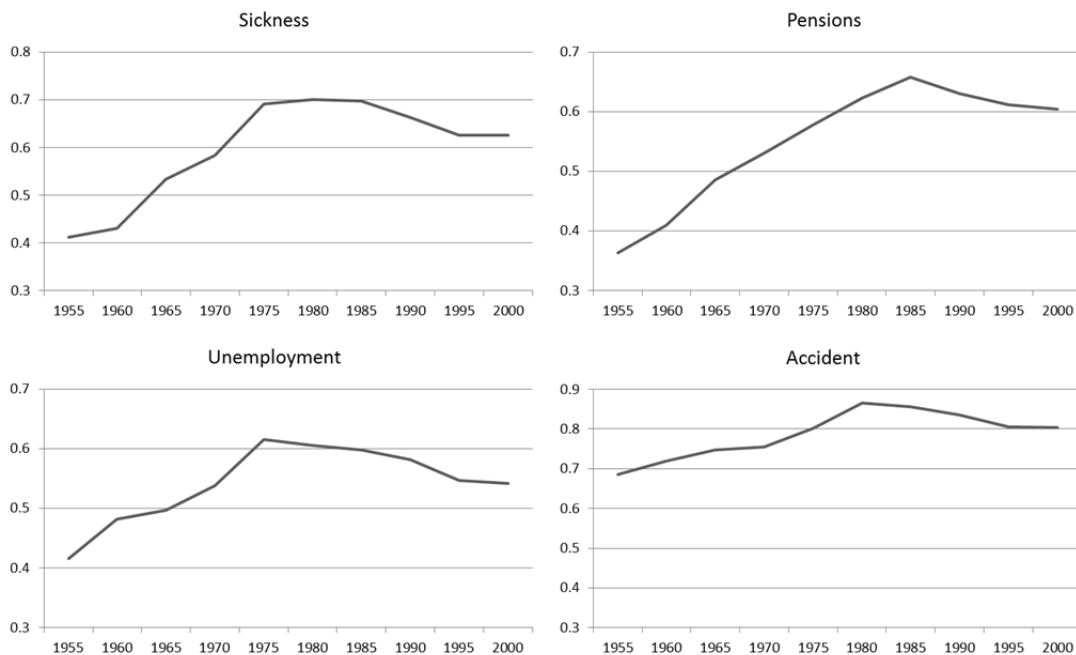
INTRODUCTION

In the academic literature, the welfare state is understood as an institutional combination of a market economy with a comprehensive, rights-based system of social protection which includes the provision of cash benefits and social services as well as a broad set of regulatory policies. As a modern form of statehood, it is not confined to a few European countries, but extends across the Atlantic (and even further, across the Pacific towards Japan and the Antipodes). Historically, its main objective was to compensate for income losses related to occupational risks and the vicissitudes of life such as old age, unemployment, work injury or death. Today, the welfare state has taken on additional goals – including gender equality and social investment – and it has become one of the heavy weight items in the public budget, attracting more than 50 per cent of total public expenditure in virtually all rich democracies (Castles, 2007). Yet about hundred years ago, the average social transfer spending share amounted only to 3.5 per cent of total public spending in 1910 (Cusack, 2007: 105; Lindert, 2004: 172). Much of that dramatic growth took place within a relatively short period that stretched from 1945 to the mid-1970s. The traumatic experience of war, Depression and the breakdown of democracy in several countries during the ‘age of catastrophe’ of the first half of the century (Hobsbawm, 1994) was a crucial impetus for the creation of a new political and economic order in the post-war era through the re-establishment of democracy, universal human rights and the taming of unfettered capitalism through a new financial and monetary settlement agreed upon in Bretton Woods in July 1944. Already three years earlier, the Atlantic Charter envisaged the guarantee of basic social rights as an essential element of the new post-war era and eventually paved the way for the more comprehensive catalogue of social rights embodied in the Universal Declaration of Human Rights adopted in 1948 (Nullmeier and Kaufmann, 2010: 84-85). Framed by a growing influence of Keynesian ideas it was considered as an institutional vehicle that could help to smooth economic volatility, generate mass loyalty through the provision of universal social rights and, in consequence, to stabilize democracy. Moreover, the rebuilding of war-torn economies and the social needs of millions of victims of war required massive state interference.

The period between 1945 and 1975 witnessed a significant extension of social rights to new groups of beneficiaries, higher levels of benefit generosity, eased eligibility rules, and the introduction of new programs such as family cash benefits or social services. Figure 1 depicts this marked increase in average benefit generosity for four pro-

grams in 18 advanced democracies between 1955 and 2000. Even though these charts mask considerable cross-national differences in welfare generosity, they illustrate not just the expansion, but also that this expansion of social rights came to a halt between the mid-1970s and early 1980s when Western democracies were hit by two consecutive oil shocks. However, these exogenous shocks were just the prelude of a series of occurrences that gave rise to a markedly changed international political economy which, along with fundamental transformations in society such as aging and increased female labor market participation, has generated a number of new challenges for advanced welfare states. As figure 1 reveals, many countries responded with welfare cutbacks since then. However, retrenchment is not the only game in town. Most countries have structurally remodeled their systems of social protection over the last three decades by imposing cutbacks in some policy areas while expanding benefits and adopting new priorities in others in order to adapt their welfare states to a fundamentally changed environment.

Figure 1: Average net replacement rate in 18 OECD countries, 1955-2000



Note: Net replacement rate for an average production worker (APW) Unemployment, Sickness and Accident program: average of four components: a) a single person vs. b) a four-person family, and c) short term (first week with benefits) vs. d) long term (26 weeks with benefits). Old age pensions: average of the APW replacement rate for a single person and a couple.

Source: Korpi and Palme (2007).

The goal of this working paper is to describe the broader contours of change in about 20 ‘core’ OECD welfare states since the 1970s against the background of the post-war settlement. In the following sections, we will trace this transformation on the basis of both quantitative macro-data and qualitative information from the secondary literature. We

show that welfare states have partially converged, especially when it comes to various spending measures, but also with regard to specific qualitative policy-making patterns. We furthermore argue that what has emerged can best be described as the ‘supply-side welfare state’ model and that this new overall orientation is reflected in many sub-areas of the welfare state. The paper is structured as follows: The next section briefly discusses the driving forces that facilitated the massive expansion of the welfare state in the so-called ‘Golden Age’ and sheds light on the factors shaping the variation among advanced welfare states in the post-war OECD world. Then, we discuss a broad set of challenges to which mature welfare states are exposed since the 1970s, before sketching the contours of welfare state change in the post-‘Golden Age’ period and analyzing the transformation of the welfare state in response to these challenges. The final section deals with the responses to the recent global economic crisis and speculates on its long-term repercussions for social protection.

THE OLD ORDER:

POST-WAR EXPANSION AND THE VARIETY OF WELFARE REGIMES

Much of our knowledge about the forces that have shaped the expansion of the welfare state in the 20th century is related to inquiries investigating cross-national differences in (gross) public social expenditure. Even though spending data is flawed in several respects, the empirical evidence reveals a consistent picture of the determinants driving the spectacular growth of the welfare state in the post-war period. Demography and unprecedented levels of economic growth are among the most important structural forces that facilitated a massive expansion of benefits during the bonanza years of the welfare state (Lindert, 2004; Wilensky, 1975), creating both rising social needs and the fiscal resources required for social security expansion. This was further accelerated by the triumph of mass democracy and the closely connected credit-claiming strategies pursued by office-oriented policy-makers under conditions of fierce electoral competition (Pierson, 1994). Not surprisingly, social spending levels as well as benefit generosity remained very low in the economically backward autocratic regimes of Southern Europe.

In the immediate post-war period, economic growth in North-western Europe was bolstered first by post-war reconstruction, and later by trade liberalization in the wake of the formation of the EC and the EFTA in the late 1950s. The deepening of economic integration was a further lesson of war which, however, in the beginning did not include free capital markets. Given restricted exit options for business and taxpayers, governments could practice redistributive policies by taxing corporations and capital and squeezing the wage differentials between different skill levels (Scharpf, 2000). In addition, regime rivalry between the democratic West and the communist regimes in Eastern

Europe contributed to the post-war expansion of the western welfare state. Facing a real social alternative in the East, Western governments used the provision of social rights as a strategy for generating mass loyalty during the Cold War (Obinger and Schmitt, 2011).

While all these factors provided favorable conditions for public intervention across the OECD, we can nevertheless observe a considerable diversity in terms of social spending, benefit generosity and institutional patterns. In other words, there was no single road to the welfare state as early functionalist accounts had suggested, but rather various ways to and through modernity (Castles, 1998; Therborn, 1995). Comparative welfare state research has identified a battery of variables accounting for these cross-national differences. To begin with, national welfare states evolved out of their unique institutional heritage that dates back at least to the 1880s. Spending dynamics were strongly related to the age of the national social security system (Wilensky, 1975) and early choices about basic structural program characteristics such as benefit eligibility rules, coverage and the mode of financing shaped subsequent developments (Alber, 1982).

Political factors play an overriding role for explaining cross-national policy variation during the 20th century. According to arguably the most prominent theoretical account of comparative welfare state research – the so-called ‘power resources approach’ –, the welfare state is an outcome of a ‘democratic class struggle’ (Korpi, 1983). Left power resources inside and outside parliament are considered as the main factor conducive to generous and universal social protection (Castles, 1978; Korpi, 1983; Stephens, 1979). Later on this view was modified as Christian-democratic parties were also systematically identified as powerful supporters of the welfare state, albeit in distinct ways (Manow and van Kersbergen, 2009; van Kersbergen, 1995). The most comprehensive welfare states therefore emerged in countries where government was controlled by strong left and/or Christian-democratic parties. Moreover, voter turn-out, contagion effects between parties, and strong trade unions have been identified as factors driving up social spending. By contrast, the expansion of publicly provided welfare was significantly constrained in political settings dominated by liberal and secular conservative parties as found in North America (Garrett, 1998; Hicks and Kenworthy, 1998; Hicks and Misra, 1993; Hicks and Swank, 1992; Huber et al., 1993; Huber and Stephens, 2001).

However, the power of pro-welfare state parties and unions is a necessary, but not a sufficient condition for welfare state expansion. The room to maneuver of policy-makers is to a considerable extent preconfigured by political institutions. In fact, institutional veto points have decisively impeded the expansion of the welfare state (Bonoli, 2001; Huber et al., 1993). Examples of such institutional barriers to policy change include inter-state federalism in North-America, Australia and Switzerland (Obinger et

al., 2005), direct democracy (Immergut, 1992), constitutional courts or presidential veto powers. In consequence, veto-ridden state structures have considerably shaped the public-private mix in welfare provision since any failure of public solutions often paved the way for private and occupational benefits or hidden forms of welfare provision such as regulation or tax expenditures (Hacker, 2002). In contrast, neo-corporatist institutions, which emerged in several small European countries (Cameron, 1978; Katzenstein, 1985), turned out to be conducive to welfare state expansion.

Another source of cross-national social policy variation that is emphasized in the literature is ethnic fragmentation. Historically, the welfare state is a child of industrialization and the nation state (Flora, 1986). The collapse of multi-national empires in the aftermath of World War I and the catastrophe of World War II led to high degree of ethnic homogeneity in most European societies (Therborn, 1995). Some scholars argue that ethnically homogeneous nation states were much better able to achieve legitimacy for a redistributive regime among its members compared with ethnically or linguistically fragmented societies such as the United States, Canada and Switzerland (Alesina and Glaeser, 2004; Lindert, 2004, vol. 2: 71).

Hence, two sets of factors explain cross-national welfare state development in the post-war period. The first set accounts for its dramatic expansion across *all* OECD countries. The second set, however, underpins the differences that deepened *between* them. In an effort to better understand these differences, various classificatory attempts have been made. Esping-Andersen's (1990) typology of three ideal-typical welfare regimes is arguably the most important one (Ferragina and Seeleib-Kaiser, 2011). He distinguishes three ideal-typical welfare regimes.

The most encompassing model of the welfare state is the *social democratic regime* that emerged in the Nordic countries under social democratic hegemony, notably in post-war Sweden. Benefits are universal and citizenship-based and often tax-funded. Active labor market policy and encompassing social services with a view to simultaneously unburden women from family work and to increase (female) employment are characteristic features of this model. Public service provision contributes to generate middle-class loyalty. Both benefit generosity and spending levels are high so that markets are crowded-out from benefit provision.

By contrast, the *liberal regime*, to be found in the English-speaking world celebrates individualism, self-responsibility and an anti-state ideology. It emerged in settings with liberal and secular conservative incumbency. This regime only offers minimum and means-tested benefits as well as flat-rate insurance benefits, while the social protection of the better-off is left to markets and private or occupational initiative. Coverage of public programs is therefore low and the main objective is poverty alleviation. What is peculiar in some English-speaking nations is an approach relying on 'social protection

by other means' (Castles, 1989), including the large hidden welfare state based on tax breaks and occupational welfare in the U.S. (Hacker, 2002; Howard, 1999) and a broad set of regulatory policies historically protecting wage earners in the Antipodes (Castles, 1985). In all cases, however, public benefits are meager and designed to cover only basic needs.

The *conservative-corporatist regime* in continental Europe is arrayed between these poles. Its most salient factor in political terms is the pivotal role of Christian democratic parties. Occupational position, status, hierarchy, and the notion of a male breadwinner are therefore central. Benefit eligibility is attached to labor market participation and marriage and the level of benefits is merit-based and rises with income and the employment record. Mandatory and occupationally fragmented social insurance funded from contributions by employers and employees is the dominant program. Service provision, in contrast, is weakly developed as care work is traditionally left to families, i.e. women.

Despite various lines of criticism (Arts and Gelissen, 2010; Scruggs and Allan, 2006; 2008) and suggestions of additional welfare state types¹, this seminal typology is still a very helpful heuristic device for understanding the impact of different welfare state types on equality, employment patterns and gender relations, their vulnerabilities in a changed socio-economic environment, and their reform opportunities.

CHALLENGES TO THE OLD ORDER

Both the academic and the political debate in the 1990s and early 2000s centered on external challenges to the welfare state, notably economic globalization and European integration. The impact of globalization – i.e. lower barriers to trade and capital flows between countries – may come through two main mechanisms (for overviews, see Genschel, 2004; Mosley, 2007; Swank, 2005). The first is regulatory and tax competition between jurisdictions. Here, the expectation is that increased exit options for capital leads to a 'race to the bottom' of regulatory levels, tax rates and, in consequence, welfare state generosity and spending. The second theoretical mechanism, which is largely ignored in the political debate, is the so-called compensation thesis. It expects the (potential) losers of economic opening to demand compensation in the form of social welfare benefits (Burgoon, 2001; Hays et al., 2005). Hence the expectation that, instead of a race to the bottom, we should find persistent, if not increased levels of social provision, at least in some areas of the welfare state. While both hypotheses have been extensively

¹ For example, Castles argues that the Antipodes maintained a so-called wage earner's welfare state until the 1990s, while Ferrera (1996) claims that the Southern European countries form a distinct type of their own.

tested (Busemeyer, 2009), no scholarly agreement has emerged so far about the overall impact of economic globalization on the welfare state.

The economic dimension of European integration can be seen as a particular form of globalization at the regional level. The Maastricht Treaty of 1992 and the enlargement of the European Union (EU) to an ever more diverse group of member states drew attention to questions about the impact of integration on national welfare states and the prospect of a supranational welfare state. Again, several channels of influence on domestic welfare states are relevant and have been extensively discussed. The first channel is the direct impact of EU legislation in social matters. Due to a lack of competences in some of the core fields of the welfare state (e.g. social protection), the impact of EU legislation has been limited so far and earlier hopes and fears about a supranational welfare state have been muted. Much more important seems the second channel, the indirect impact of common market compatibility requirements, backed by a powerful European Court of Justice (Ferrera, 2005; Leibfried and Pierson, 1995). In addition, increased cross-border competition within the common market may lead to downward pressures via regulatory and tax competition. Whether and to what extent European integration has put constraints on national welfare states remains controversial (Caporaso and Tarrow, 2009; Scharpf, 2010). It is nevertheless safe to conclude that the process of market-building in Europe (‘negative integration’) has put European welfare states under considerable reform pressure, while the re-regulation of social policy at the EU level (‘positive integration’) has progressed rather slowly due to the high level of political consensus required for shifting policy jurisdiction to the EU level.

Since EU social policy harmonization via ‘hard law’ is difficult to achieve, the EU has tried to establish a variety of ‘soft’ governance mechanisms in the social sphere (Trubek and Trubek, 2005). The so-called Open Method of Coordination is designed to spread best practices – and sometimes discourage bad practices – among member states. It is plausible to assume, however, that cross-border policy learning is not confined to the EU. Both learning and competition are increasingly seen as two mechanisms of the larger phenomenon of policy diffusion. While not an entirely new idea (Collier and Messick, 1975), policy diffusion has only recently been taken up by mainstream welfare state research. Diffusion studies look more closely at the interdependencies of welfare states and the mechanisms through which national choices are conditional on others’ choices (Gilardi, 2010; Obinger et al., 2013; Weyland, 2006).

In addition to these external challenges, mature welfare states have also been confronted with a broad set of domestic challenges. One results from structural economic change, notably the transition from industrial to post-industrial economies (Wren, 2013). The lower productivity of the service sector reduced economic growth and led, in consequence, to lower wage growth. Technological progress, lower economic growth

and economic globalization have increased the unemployment risk of the less-educated workforce. Moreover, employment gains in the private service sector can often only be achieved at the expense of higher wage inequality unless the public sector exercises a compensatory function. The latter strategy, however, is increasingly foreclosed as mounting budgetary problems and privatizations imposed considerable limits for enhancing public sector employment. In addition, the higher wage premium on education in knowledge-based post-industrial economies increased the wage differentials between different skill levels. Hence, some scholars diagnosed intractable trade-offs between employment growth, income equality, and sound state finances (Iversen and Wren, 1998; Scharpf, 2000).

Moreover, higher flexibility requirements in service economies and mounting unemployment are said to have increased the pressure to deregulate labor markets, giving rise to the spread of various forms of atypical employment such as part-time work, temporary work, or fixed-term employment. The resulting decline of standard employment particularly represents a major challenge for continental welfare states since precarious employment is, by virtue of the tight nexus between benefit levels and employment record, translated into low welfare benefits.

Recent decades also witnessed a massive rise of female labor market participation. Even though this often occurred only on a part-time basis (O'Reilly and Fagan, 1998), labor market entry of women increased demands for policies that help to balance employment and family work which typically has been delivered by women (Lewis et al., 2008; OECD, 2007). In addition, traditional family patterns underwent significant changes over time. Rising divorce rates and an increasing number of lone parent households undercut the welfare production capacity of families and went along with higher poverty risks (Misra et al., 2012).

Demography remains a permanent issue. While life expectancy has been constantly rising for a long time, the new challenge is the sharp decline in fertility rates since the 1970s in many countries. This is of particular relevance for pay-as-you-go funded pension schemes as a shrinking working age population has to support a growing number of pensioners. Moreover, the 'greying of society' has increased demands for long-term care for the frail elderly.

Finally, labor migration, setting in during the boom period of the 1960s, led to a growing ethnic heterogeneity of Western societies over time what, according to some scholars, will reduce solidarity in contemporary societies and drive Europe towards a more American-style social policy (Alesina and Glaeser, 2004). However, this scenario is contested in the literature.

Taken together, risk patterns have changed considerably over time. Poverty has demographically spilled downwards from the elderly to single parents, families with many

children and the less-educated labor force, of which many are migrants. As a result, old welfare states increasingly confronted with new social risks and new demands, thus calling not just for more welfare provision but also for a different kind of welfare state (Armingeon and Bonoli, 2006; Esping-Andersen et al., 2002; Taylor-Gooby, 2004). What is more, the political basis of the welfare state itself has been subject to a profound transformation. De-industrialization and the continuing decline of the agrarian sector have led to the erosion of the early post-war class structure. Along with secularization these developments undercut the power resources of Social and Christian democratic parties as well as of trade unions, that is, exactly those collective actors that had backed the post-war expansion of the welfare state most extensively. Green parties and anti-welfare right-wing populists have transformed European party systems since the mid-1980s. Moreover, a significant part of the labor force is disenfranchised due to lacking citizenship, whereas the unemployed and the less-educated in precarious employment show growing tendencies of political apathy (Schäfer, 2010). On the other hand, well-organized welfare state constituencies such as pensioners emerged as new actors which forcefully defend their social entitlements (Pierson, 1994). In a nutshell, also the politics of social policy has undergone major changes over the past decades (Bonoli and Natali, 2012).

In sum, the combination of external and domestic challenges put mature welfare state under considerable strain. While new risks patterns, mounting unemployment, demographic changes, and higher female labor market participation generated social needs and pressure for additional financial resources, lower economic growth, international tax competition and supranational debt limits have imposed tight fiscal constraints on nation states. What is more, this dilemma needs to be resolved by political systems which have lost a great deal of autonomy and sovereignty in the wake of Europeanization and globalization. The next section illustrates the ways in which advanced democracies have responded.

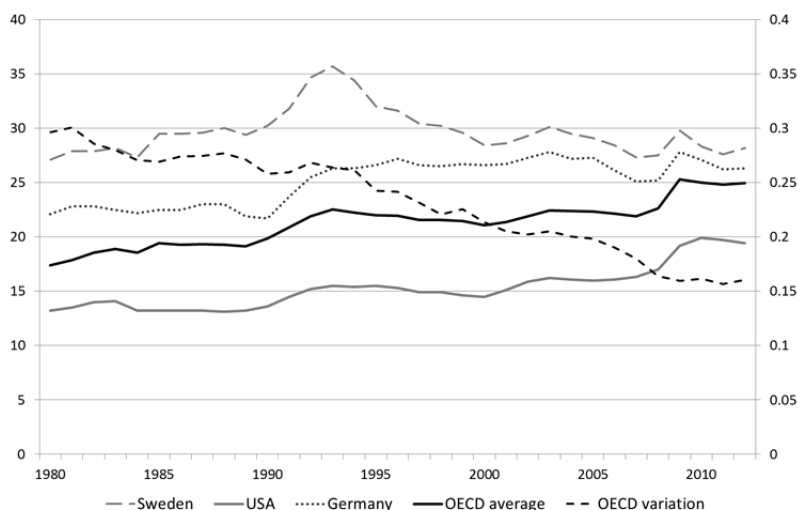
TRANSFORMATION OF THE WELFARE STATE: A NEW ORDER?

The size and generosity of the welfare state

OECD welfare states have been transformed into something that most observers in the 1980s and 1990s did not expect. There has been clear policy convergence. Yet rather than resembling a residual, low-expenditure, ‘liberal’ form, OECD systems of social protection have remained large, but transformed into increasingly market-conforming, ‘enabling’ (Gilbert, 2002) welfare states. The new order is difficult to grasp with categories of more and less, state vs. market, public vs. private. We will try to delineate the

long-term transformation, starting at the most general level of analysis before drilling down to the level of subareas of the welfare state and more subtle qualitative changes.

Figure 2: Total public social expenditure as a percentage of GDP (left axis) and coefficient of variation (right axis), 1980-2012



Source: OECD Social Expenditure Database, OECD.stats

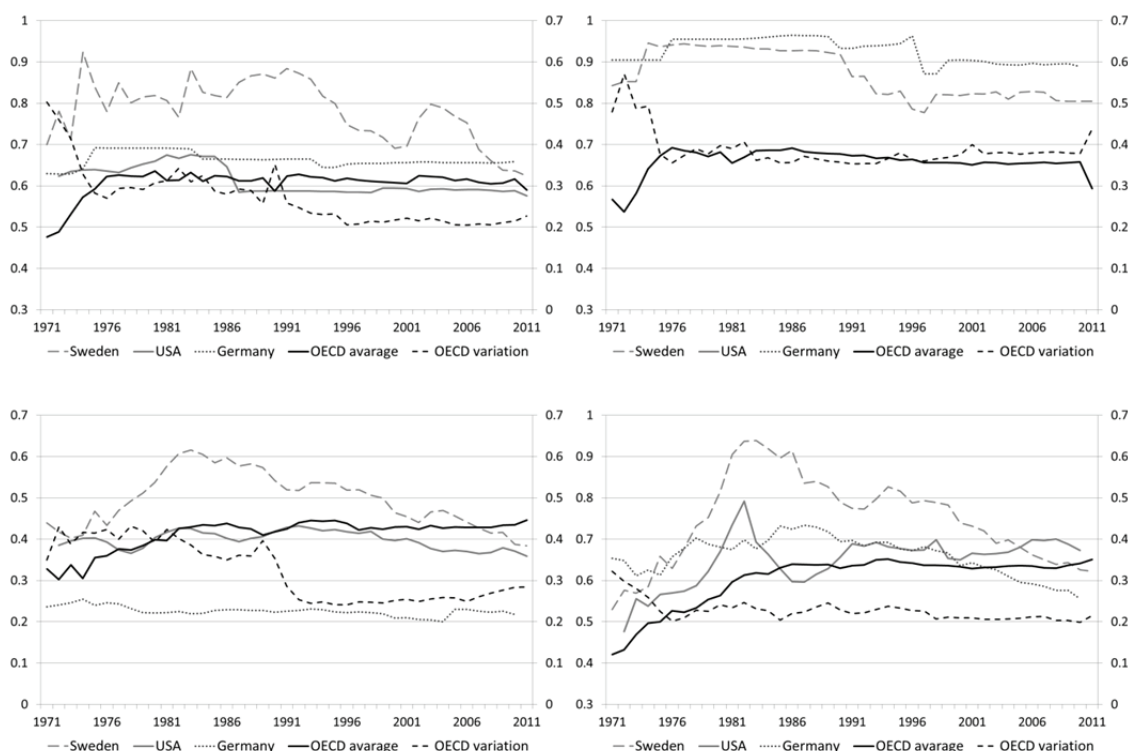
First of all, despite the fears – or hopes, depending on one’s political leanings – about the end of an era of ‘big government’, large welfare states have not disappeared. What is more, it turns out that ‘big government’ is even more pervasive than ever (Pierson, 2011). A simple look at the main aggregate indicators supports this general conclusion. Figure 2 displays the evolution of the unweighted mean of social expenditure ratios in 21 OECD countries (black line), the coefficient of variation (dashed black line) and spending trajectories in three very different prototypical welfare states – Germany, Sweden, and the United States – between 1980 and 2012. The three countries are only used for illustrative purposes.² Simple visual inspection reveals the main pattern. Social expenditure as a percentage of GDP – the common measure of ‘welfare state effort’ (Wilensky, 1975) – has stagnated or grown in most OECD countries, not decreased. The average over-time pattern we see is far from dramatic, especially compared to the three decades prior to 1980, and essentially in line with Peter Flora’s characterization of a ‘growth to limits’ of the OECD welfare state (Flora, 1986). We see an upward movement of the mean, combined with decreasing variation. In other words, public social expenditure development is marked by absolute *convergence to the top*, not a race to the bottom. This *prima facie* impression has been confirmed by more detailed analyses (Schmitt and Starke, 2011; Starke et al., 2008). For most countries, we can also detect

² These three countries are often seen as near-perfect real-world approximations of, respectively, the conservative, the social-democratic and the liberal welfare models.

the impact of the worldwide recessions – in the early 1990s and, more recently, in 2009 – on welfare effort, visible as an upwards ‘dent’ largely due to rising beneficiary numbers and a simultaneous decrease in the denominator (i.e. GDP). In addition, the importance of the welfare state function relative to other state functions has grown rather than decreased over time, as the share of social expenditure relative to total government outlays has significantly increased since 1980 (not shown, see Castles, 2007). Differences in the level and the growth of social spending are explained by domestic socio-economic conditions in the first place, above all, by demographic ageing, economic growth rates and unemployment. In contrast, the explanatory strength of political factors, including the partisan composition of government parties has disappeared in recent decades, according to most analyses of aggregate social expenditure (Huber and Stephens, 2001; Kittel and Obinger, 2003; Kwon and Pontusson, 2010).

Looking at aggregate spending is clearly not sufficient, however. Given the increased demands due to changing demographics and other structural changes described earlier, this upwards convergence in spending perhaps masks a more subtle retreat of the state at the level of individual entitlements or ‘social rights’ (on the concept, see Stephens, 2010). A central aspect of social rights is the level of income that is replaced by transfers (e.g. unemployment, sickness or pension benefits) during out-of-work periods. Net replacement rates, a central measure of social rights, reflect the relationship between the (net) income of an average beneficiary relative to the (net) wage of an average production worker. They are calculated for different household types (single household, single breadwinner family etc.). The most detailed data available for the time period of interest comes from the Welfare Entitlements Dataset compiled by Lyle Scruggs (2013). Figures 3a-d display the development of net replacement rates for four different benefits between 1971 and 2011. The picture is less clear-cut than for expenditure data. Especially for unemployment and sickness benefits, a great deal of change is visible but it seems quite heterogeneous in terms of the direction of change. Some countries have seen welfare state retrenchment while others have seen an expansion in benefit generosity. The trend in minimum and standard pensions points upwards. Absolute convergence is taking place in all benefit types except sickness benefits, and again, it is a convergence to the top (pensions) or to the middle ground (unemployment), rather than a ‘race to the bottom’. However, the existing heterogeneity within the group of OECD countries also indicates that replacement rates are strongly shaped by domestic political forces, a suggestion that is borne out by most existing studies (Allan and Scruggs, 2004; Amable et al., 2006; Korpi and Palme, 2003; Swank, 2005).

Figure 3a-d: Average net replacement rates (left axis) and coefficient of variation (right axis) of unemployment benefits, sickness benefits, standard and minimum pensions (clockwise from top left), 1971-2011



Notes: Net replacement rate data is based on hypothetical model households. For unemployment and sickness replacement rates the mean of a single household and a household with one full-time average earner, a dependent spouse and two children was calculated. For pensions, the average is based on the mean out of a single pensioner and a married couple.

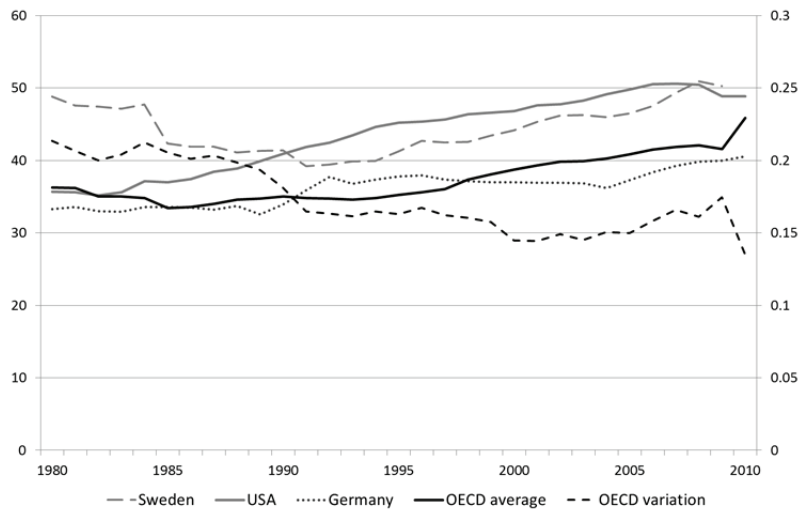
Source: Comparative Welfare Entitlements Dataset (Scruggs, 2006).

The changing instruments of the welfare state

How can we reconcile this finding that politics do matter for measures of individual social rights with the finding that aggregate social spending is largely driven by socio-economic forces? One answer lies in the changing instruments the welfare state uses. Figure 4 shows how direct cash transfers – which reflect the individual entitlements included in the Scruggs database – have gradually lost in importance across the OECD at the expense of benefits ‘in kind’, mainly social services such as health care, public child care, and residential care for the elderly (Castles, 2005). Over 40 per cent of what is spent on social matters is now spent on services and goods, on average. Yet the rise of the ‘social service state’ does not follow the same rules as the traditional transfer state. It is associated with the socio-structural changes mentioned earlier, namely deindustrialization and rising female labor force participation (Jensen, 2011b) and appears to be a relatively ‘apolitical’ process compared to previous expansionary periods (but see Gingrich, 2011; Häusermann, 2006). In sum, total spending may be increasingly shaped

by two different political logics at once – an old logic of the transfer state and a new politics of the service state – which cancel each other out in the aggregate.

Figure 4: Total public social expenditure in kind as a percentage of total public social expenditure (left axis), coefficient of variation (right axis), 1980-2010



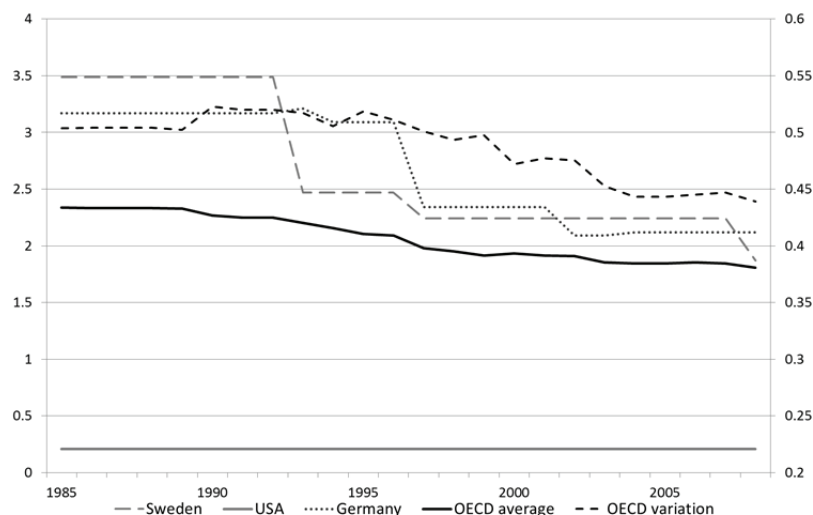
Source: OECD Social Expenditure Database, OECD.stats.

What about social regulation, the third policy instrument in the welfare state's toolbox? Unfortunately, there is very little cross-national quantitative information available about social policy regulation over time. One important regulatory field, however, where such data has become available, is labor market regulation. Figure 5 demonstrates the process of marked liberalization and convergence in employment protection legislation (EPL) (e.g. the regulation of dismissals and the use of temporary contracts). The downward trend is mainly driven by changes in the regulation of temporary employment, while liberalization has been much more moderate in the regulation of regular employment, thereby increasing the 'dualizing' divide between labor market insiders and outsiders (Emmenegger et al., 2012).

Through this simple descriptive analysis of the available quantitative data, we have established that OECD welfare states have become more similar. Moreover, today's welfare states depend relatively less on cash transfers and traditional regulatory instruments (such as EPL) and more on social services. This does not mean that the old welfare state is dead. On the contrary, a large body of literature has shown how change is heavily influenced by institutional heritage (Hacker, 2002; Pierson, 1994; 2004). The changes we observe are gradual developments, not sudden switches. We will now look at important subareas of the welfare state and describe in more detail some of the defining trends in terms of *how* welfare states do what they do (see Castles, 2008). On the basis of a review of the rich qualitative literature, we are able to discern four major trends: multi-pillar pensions, labor market activation, an expansion of the state's role in

family policy, and experimentation with new forms of governance and funding mechanisms in health care.

Figure 5: *Strictness of employment protection (overall, left axis), coefficient of variation (right axis) 1985-2008*



Source: OECD Labour Force Statistics, OECD.stats.

What welfare states do (differently) today

In the field of *old age pensions*, the dominant theme has been the shift towards so-called ‘multi-pillar’ pension systems (Clark et al., 2006; Ebbinghaus, 2011; Immergut et al., 2007; OECD, 2009; 2011; Whiteford and Whitehouse, 2006). The World Bank promoted multi-pillar pensions in the 1990s as a key to solving what was considered a looming ‘old age crisis’ (World Bank, 1994). It claimed that the optimal pension mix rests on three pillars: first, a small, tax-finance basic pillar to prevent poverty in old age; second, an earnings-related occupational pillar and, third, individual private savings as a voluntary top-up. For some countries, this must have sounded like old news as they had already started to shift the task of paying for old age onto several ‘pillars’ decades ago. In the middle of the twentieth century, OECD pension systems divided relatively neatly into two types of groups: Bismarckian systems (e.g. Germany, Austria, Italy, United States) on the one hand, and Beveridgean systems (e.g. United Kingdom, Sweden, Canada, Denmark) on the other (Hinrichs and Lynch, 2010). Things got messier afterwards. The Beveridge countries started to change first and supplemented their universal, flat-rate pension with new earnings-related layers, sometimes on an occupational basis, between about the 1960s and the early 1990s.

Bismarckian pension systems, however, tended to stick to a single social insurance pillar and, up to the 1990s, reforms took place *within* the inherited institutions. Bismarckian countries also have the highest levels of public pension expenditure combined

with the least favorable demographic outlook (the United States excepted). It comes as no surprise that calls for pension reform grew louder in these countries. From the late 1990s onwards, most Bismarckian countries legislated significant structural changes. The future direction of pension systems across the OECD has clearly been tilted into a multi-pillar direction. Apart from some cutbacks to first-pillar pensions – some of which will come into full effect only after a long phase-in period – second and third-pillar pensions were added to the mix. Most Bismarckian countries have either added mandatory occupational or private pensions (e.g. Sweden) or subsidize and regulate private retirement savings much more extensively than before (e.g. Germany).

On the whole, Bismarckian and Beveridgean countries have to some extent converged, which is also suggested by the quantitative indicators (see above). Overall, the lines between public and private have become much murkier (Béland and Gran, 2008). It could even be argued that the role of the state has not greatly diminished but new tasks of financial regulation and consumer protection have been added that used to be anathema in pension policy. Differences remain, however, in terms of the average level of benefits guaranteed by the state, the extent of redistribution, and the role the state plays vis-à-vis private provision in terms of subsidization and regulation. Negative consequences have also arisen from multi-pillar reform. The financial crisis of 2008 was a powerful demonstration of the potential for political conflict that comes with a shift towards promoting more private retirement savings. Moreover, given changes in family structures, mass unemployment and the spread of atypical work, there is a real danger that pension reforms aimed at cost saving also lead to higher inequality and poverty in old age (Meyer et al., 2007), which is why some countries have already improved minimum retirement income schemes.

Labor market policy used to be mainly about passive income replacement during unemployment spells (Sjöberg et al., 2010). The insurance of employees stood at the center and benefits were typically earnings-related to allow for a maintenance of an achieved individual living standard during temporary joblessness. High unemployment benefits also had the positive side-effect to act as Keynesian automatic stabilizers during downturns. Active labor market policy (ALMP) did exist in some countries – Sweden is a positive outlier in this respect – but, overall, did not have such a predominant role. The persistence of structural and long-term unemployment in the 1980s and 1990s led to changing goals and instruments of labor market policy in all OECD countries, albeit to a varying extent. Arguably, this development was influenced by initiatives at the level of the OECD and the EU in the 1990s (Casey, 2004; Mosher and Trubek, 2003; OECD, 1994). Labor market activation has become the term to describe this transformation (Kenworthy, 2010: 435-437, provides an overview of the reasons and causes of activation).

A huge variety of activation reforms can be observed across the OECD (Eichhorst et al., 2008; King, 1995; Lødemel and Trickey, 2001). The most important measures include cutbacks of some passive benefits (especially long-term benefits), stricter requirements in terms of individual job search and participation in special programs. Many countries, however, have also improved services for the unemployed (and for potential employers), including better job search assistance, access to child care and training measures. One method of increasing employment has been to ‘make work pay’, either through benefit cutbacks or through in-work benefits (e.g. by relaxing means tests or by introducing tax benefits for low wage earners) (Nolan, 2006).

Different approaches to activation differ in their mix of stick and carrot or, put differently, between ‘workfare’ and more ‘enabling’ instruments (Dingeldey, 2007). Another distinction is based on whether a broad array of policy instruments (beyond the more traditional instruments of ALMP) are used and whether the goal is long-term employment in ‘good’ jobs or just employment (Kenworthy, 2010). It is also possible to distinguish between demand-side measures – e.g. public jobs creation, employer subsidies, short-time working schemes – and supply-side measures – e.g. work requirements, placement services, training. Notwithstanding this diversity, there are common themes that have emerged across virtually all countries since about the 1980s. In essence, instead of just insuring participants in the labor market against the consequences of unemployment, activation is driven by the goal of increasing overall labor market participation and particularly the employability of those at the margins of the labor market. Since many who are to be ‘activated’ are not even among the registered unemployed, activation often entails coordinating or integrating labor market schemes with social assistance, education and training, and family policy. Hence, and despite continuing differences *within* the activation approach, it can be argued that qualitative policy convergence – or ‘contingent convergence’ (Konle-Seidl and Eichhorst, 2008) – has taken place in the labour market policy of OECD countries.

Across the OECD, *family policy* has gained a prominence it never had in the history of the welfare state. As mentioned before, this is true at the level of expenditure. Expenditure on families (cash and in-kind) has increased since 1980 and now stands at 2.5 per cent of GDP (OECD-21 average). Compared to the big program areas such as old age and health care, this share is still relatively small. But even beyond the question of resources, family policy has been transformed into something new (Bahle, 2008). When it emerged in the post-war years – there had been very little activity in this field before 1945 – it was often geared towards the male breadwinner model and its main goal was to compensate for the cost of raising children and the alleviation of poverty. But there were differences between countries, which still affect current trajectories. In many countries – especially Catholic countries or countries marked by historical religious

conflicts – the family realm was almost off-limits for the state and family policy was mainly guided by the ‘subsidiarity’ principle.

The goals and instruments of family policy have since diversified and have been aligned much more with overall economic and labor market policy objectives and, at least in part, with goals of gender equality (Lewis, 2009). In line with the activation paradigm, the focus is increasingly on raising mothers’ employment rates, the reconciliation of employment and family and on early investment in children (Esping-Andersen et al., 2002; OECD, 2007). Of course, the extent to which this is done differs markedly across countries. ‘New’ family models such as the dual earner/dual carer model (Gornick and Meyers, 2006) are far from universally dominant. In Southern and large parts of Continental Europe, a lack of adequate childcare facilities and various disincentives built into the system of taxes and transfers still make it hard for parents to share care and paid work in an egalitarian manner (Ciccia and Verloo, 2012; Lewis et al., 2008). And while some of these ‘laggard’ countries have recently started to move, others, including countries such as Greece and Switzerland but also the United States and some other English-speaking countries, are in risk of falling behind. The pioneers in Northern Europe do not stand still and keep updating their family policy arrangements, despite some more traditional turns in Denmark and Finland in recent years. This widening gap between the North and much of the rest is also reflected in the lack of a clear convergence trend in family policy (Ferrarini, 2006; Gauthier, 2002). In sum, family policy has been expanded – especially in the sense of work-family reconciliation policy –, but the picture remains diverse, and sometimes contradictory, across the OECD.

Health care has been another field of unequivocal welfare state expansion. With the average share of GDP spent by general government on health care increasing from 5 in 1980 to 7.5 per cent in 2009³(OECD-21), the issue of budgetary pressure has certainly gained in importance – although it cannot be claimed that costs are ‘exploding’ in any sense of the word. Upwards convergence in spending levels is even stronger in health care than in other sub-areas of the welfare state (Starke et al., 2008). This upwards trend is fuelled by several sources (see Freeman and Rothgang, 2010: 372, for an overview), including rising income levels, technological and medical progress and so-called ‘Baumol’s cost disease’ according to which services such as health care become more expensive over time because productivity increases in services are slower than in manu-

³ Private funding sources added another 2.7 percentage points in health spending, on average, in 2008. This figure, however, is heavily driven by the United States where voluntary and mandatory private health care spending amounted to 6.1 per cent of GDP in 2009.

facturing but wages are not adjusted accordingly.⁴ Greater cost awareness has led to health care reforms in virtually all OECD countries. There is little evidence of benefit retrenchment in health care – quite the contrary, the overall trend appears to be a continuous expansion of the amount and quality of services. Instead of cutting back services, there has been numerous attempts to make health systems more efficient through structural and regulatory reform (Freeman and Moran, 2000; Freeman and Rothgang, 2010; Giaimo and Manow, 1999; Rothgang et al., 2010).

The starting points of these structural reforms were very different, however. Traditionally, health systems can be broadly grouped into tax-based and state-administered NHS systems and social insurance systems which are contribution-financed and corporatist in terms of administration. Private insurance systems are more a theoretical possibility than a reality, but the old Swiss health system and the U.S. health system (at least for large parts of the population) come closest to this third type. Since the late 1980s, countries have experimented with novel ways of health care financing and governance (Böhm et al., 2012; Götze and Schmid, 2012). Reform has become an almost constant theme in countries like the UK and Germany. The latest and most prominent example has been the 2010 Patient Protection and Affordable Care Act in the United States (‘Obamacare’) which, among other things, introduced an insurance mandate and a stronger regulation of private health insurers. Interestingly, the result of these experiments has often been that more state-dominated countries (such as the UK and New Zealand) have used the market mechanism for internal allocation of public funding. Systems that traditionally counted on fragmented private markets (e.g. Switzerland) or on self-regulation by health providers and insurance funds (e.g. Germany, the Netherlands), on the other hand, have tended to use hierarchical monitoring mechanisms and direct state intervention to curb costs. Moreover, some social insurance countries have also experimented with increased market incentives alongside corporatist and hierarchical regulation. Rothgang et al. interpret this pattern as a structural convergence of health care systems: ‘Healthcare systems show increasing similarities, as they often include innovative policies or transfer policies developed in other healthcare systems, while preserving their inherited basic features. Healthcare systems thus develop into more hybrid system types [...]’ (2010: 8).

CONCLUSION

The welfare state is not on the retreat, it is not even clearly stagnating. Some areas are marked by retrenchment but others – family policy, health care and long-term care – are

⁴ Despite frequent claims to the contrary, demographic ageing is not (yet) the main cause of spending increases (Castles, 2008; Getzen, 1992; Palangkaraya and Yong, 2009).

fields of expansion, not retrenchment. Moreover, OECD welfare states are more similar today than 30, 40 years ago. Welfare states are also less transfer-intensive and (labor market) regulation has been liberalized in many highly-regulated countries. However, several qualifications are in order regarding the process of welfare state convergence. *First*, absolute convergence is strongest with regards to social expenditure. In some sub-areas of the welfare state, it is stronger than in others. Convergence can be observed in pensions, labor market policy and health care. Family policy is marked not by convergence – perhaps not yet –but rather by a common trend of expansion. *Second*, convergence is gradual and has not led to uniformity. Differences in size and structure persist between welfare states. Despite some blurring of regimes it can be demonstrated empirically that countries still cluster pretty much in line with the welfare regime types identified by Esping-Andersen and similar welfare state typologies (Castles and Obinger, 2008; Obinger and Wagschal, 2010: 341). *Third*, while some studies have shown that convergence is driven by economic globalization (Jensen, 2011a; Schmitt and Starke, 2011), the process does not resemble the race to the bottom expected by much of the literature in the 1990s. Globalization is not the end of big government, but it has constrained the room to manoeuvre of policymakers.

As the narrative of the end of the national welfare state has lost plausibility, how can we then make sense of these developments in the OECD world? What does the ‘steady-state welfare state’ (Castles, 2004) resemble? Almost twenty years ago, Bob Jessop coined the term ‘Schumpeterian workfare state’ (1993) to capture the turn from Keynesian demand management to a focus on employability and individual labor supply. Another candidate is the ‘enabling state’ (Gilbert, 2002). The advantage of both concepts is that they focus not on a retreat of the state per se, but on changes in the way *how* the welfare state intervenes in markets and their outcomes. Yet they also seem overly focused on labor market policy, whereas changes in family policy, health care are not well reflected in these terms. Recently, Bonoli (2013) has described the changes in family and labor market policy simply as ‘active social policy’, whereas Hemerijck has proposed the term ‘social investment state’ (2012). All these classifications reflect important aspects and trends of welfare state transformation over the past 30 years, but they also tend to over-simplify the rich empirical diversity of welfare state experiences in the OECD world across the different sub-areas, from pensions to family policy. In our view, a possible term for capturing all the nuances of welfare state transformation is the ‘supply side- welfare state’. The term refers to the concern about individual (dis)incentives in terms of labor market participation, investment and other supply-side factors that underlies much current social policy-making. The term is broad enough to include activation, employability and social investment and to reflect the growing importance of incentives based on internal markets and market-compatible social provision

in contemporary advanced welfare states. The supply-side welfare state stands in obvious contrast to the demand-side oriented Keynesian welfare state of the post-war decades. This distinction should be seen as ideal-typical rather than as a clear-cut empirical finding. The emphasis on countercyclical spending in many OECD countries in the aftermath of the financial crisis of 2008, which often involved welfare state schemes, demonstrates that the break with the past is incomplete and ambiguous.

In terms of the social outcomes of the emerging new post-industrial constellation, it seems that mature welfare state face increasing difficulties to deliver on their egalitarian promise. Income inequality almost everywhere increased (OECD, 2008), with recent labor market developments characterized by a hardening divide between well-protected insiders and a growing number of outsiders, i.e. the unemployed and atypically employed. In addition, the old class-conflict seems increasingly substituted by new social cleavages along gender, ethnicity, educational attainment and age.

Of course, the future of the welfare state is open but there is not much reason for optimism in the years to come. The long-term impact of the financial crisis of 2008 and the recession that followed as well as the outfall of the sovereign debt crisis becomes more and more evident. In the short-run, the welfare state has been actively used as a short-term crisis manager and welfare state cutbacks have been the exception rather than the rule (Starke et al., 2013; Taylor-Gooby, 2012). In the medium and long term, however, the repercussions of the fiscal crisis will negatively affect public welfare provision in several countries. The recent burst of public debt, the sheer fiscal weight of mature welfare states, and the fact that many countries have already curtailed public expenditure in areas such as defense, economic affairs and education in recent past (Castles, 2007) implicate that future austerity packages can no longer spare the welfare state. At least for the heavily indebted countries it is thus very likely that the real age of permanent austerity begins now (Pierson, 2011; Schäfer and Streeck, 2013). In fact, several countries have already imposed draconic cutbacks of welfare benefits with significant repercussions for social cohesion and democratic politics. It may well be that the convergence we have observed in the last three decades will stop and a new divergence will open up between welfare states trapped in a spiral of low economic growth, high public debt and painful austerity measures on the one hand and the countries on the way towards recovery on the other.

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