Welfare State and Production Regimes in the Era of Retrenchment

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FEBRUARY 1999, PAPER NUMBER 1

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The *Occasional Papers* of the School of Social Science are versions of talks given at the School's weekly Thursday Seminar on topics we thought would be of interest to a broad audience. At these seminars, Members present work-in-progress and then take questions. There is often lively conversation and debate, some of which will be included with the papers. Our aim is to capture the interest and engagement that marks the School's programs. The School encourages work with an historical and humanistic bent: Members work in various fields of the social sciences—anthropology, economics, sociology and political science—as well as in history, philosophy, literature and law.

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During 1997-2000, the School was engaged in a four-year focus on the process of globalization and different kinds of local responses to it. The 1998-99 seminar addressed questions particular to political economy, to the interrelated processes of economic globalization and political change as they are manifest in various parts of the world. The paper that Huber and Stephens offer here directly takes up this question.

Welfare State and Production Regimes in the Era of Retrenchment is part of a larger research project on globalization and the future of national welfare state regimes; a revised version will appear in *The New Politics of the Welfare State* (tentative title), edited by Paul Pierson. Huber and Stephens are finishing a book on welfare states in advanced industrial democracies. The book compares welfare state regimes in Scandinavia, Europe, North America, Australia and New Zealand, particularly in light of the retrenchment of welfare policies in the post 1980 period. The comparison asks whether the internationalization of production and markets for goods and capital have deprived governments of essential policy tools, or undermined the political bases of support for welfare state practices and for the promotion of full employment. Huber and Stephens take up these questions not in isolation, as is often the case in discussions of welfare, but by examining how the different states' welfare regimes are embedded in their production regimes. Their methodological approach is similarly nuanced; it combines cross-national quantitative and comparative-historical analysis. Because their perspective and method are different, they can propose an alternative to the conventional argument for state welfare retrenchments (that "globalization," the increasing openness of countries to trade and financial flows, is primarily responsible for changes in internal policies), and are able to suggest the social and political conditions that would allow for the formation of alternative policy approaches. Huber and Stephens have already begun work on their next book which will extend their research on these questions to the countries of Latin America.

Welfare State and Production Regimes in the Era of Retrenchment

For the past two decades, a debate has been waged in public about the future of the welfare state. In the United States, the objective reasons for concern are the threatening deficit in social security that may result from the retirement of the baby boom generation, and the budget constraints arising from political decisions in the 1980s to cut taxes. In Europe, similar problems threaten the financial viability of pension systems in the 21st century. In addition, there is a significant increase in claimants on welfare state benefits as a result of rising unemployment. Unemployment has not only risen in cyclical downturns of European economies, but appears to have stabilized at a higher level than that found before 1973. Clearly, a significant and long-lasting deterioration of the ratio between people who pay taxes to sustain the welfare state and people who draw benefits from it is bound to put financial pressures on welfare states and require either increases in taxes or cuts in benefits.

Fiscal pressures on the welfare state and increased unemployment in Europe have occurred simultaneously with changes in the international economy generally subsumed under the label of globalization. Flows of goods, particularly capital, across borders have increased, as have the reach of transnational corporations and of production networks based on subcontracting arrangements. Because these events are concurrent, many scholars and politicians have drawn the conclusion that globalization has made generous welfare states obsolete. They argue that welfare states constitute an interference with the market that is viable only in the context of the protection of national economies through barriers to the free flow of goods and capital. In the new context of substantially liberalized national economies, advanced industrial societies will have to learn to compete in international markets by lowering labor costs. Lower labor costs will make exports more competitive and, in the European context, they will create jobs in the private service sector which is much smaller than it is in the United States. Lowering labor costs in turn requires both a reduction in negotiated wages and in contributions to welfare state programs. In particular, unemployment benefits and social assistance for the poor need to be reduced in order to lower the reservation wage and give the unemployed a strong enough incentive to accept low wage jobs.

Clearly, this interpretation of economic changes and the image of inexorable pressures on wages and welfare states emanating from the international system is a dream come true for conservative politicians. They can abdicate responsibility for policy changes that aim to lower wages and welfare state benefits and paint those who wish to defend wage and benefit levels as irresponsible populists who endanger the entire nation's economic well-being by their misguided policies. References to writings by social scientists that emphasize the constraining effects of economic globalization shore up the legitimacy of these political positions. It therefore becomes very important to subject arguments about the effects of globalization on national economies—particularly the competitiveness of industries and unemployment, and consequently on wages and welfare state programs—to close scrutiny. To do so, we need to examine the nature of, and the interconnections between, production regimes and welfare state regimes. This is the task we undertake in this paper.

In recent years, two parallel developments in social science research have advanced our

understanding of the institutional configurations of advanced industrial societies: the growing interest in different typologies of welfare states on the one hand, and the deepening study of varieties of capitalism on the other. Since the publication of Esping-Andersen's *Three Worlds of Welfare Capitalism* (1990), the dominant approach to the study of welfare states in advanced capitalist democracies has come to use the lens of a typology of three or four types of "welfare state regimes". In the study of varieties of capitalism, Soskice's (1994) distinction between flexibly coordinated and deregulated market economies focused investigators' attention on the nature of relations among enterprises, between enterprises and financial institutions, and between enterprises, financial institutions and the government (Albert 1991; Soskice 1994, 1998). Thus, it added to the literature on corporatism that had focused mainly on institutionalized interaction between the government, labor, and employers. Of course, the role of organized labor in coordinated market economies retained its importance in the literature on varieties of capitalism, or on what came to be called production regimes (Hollingsworth, Schmitter and Streeck 1993; Soskice 1994). However, this literature has not really been integrated with the study of welfare states. In their 1992 article Esping-Andersen and Kolberg argued that welfare state regimes are interrelated with different labor market institutions and policies. We expand on this idea here and attempt to link the study of welfare state regimes more systematically to the study of production regimes.[1]

We conceptualize production regimes parallel to welfare state regimes, to denote a configuration of institutions and policies. In the case of production regimes, the relevant institutions are private and public enterprises (industrial and financial), associations of capital interests (business associations and employer organizations) and of labor, labor market institutions, and governmental agencies involved in economic policy-making. We also pay attention to the patterns of interaction among all of them. The relevant policies are labor market policy, macro-economic policy, trade policy, industrial policy, and financial regulation. These institutions constitute national frameworks of incentives and constraints (Soskice 1994, 1998) that shape the behavior of actors and are relatively impervious to short-run political manipulation.

Our analysis proceeds in three steps. First, we provide a conceptualization of welfare state and production regimes and an analysis of their performance up to the 1980s. Second, we analyze pressures on these regimes and resulting welfare state rollbacks since the 1980s. Finally, we offer an assessment of possible future paths to adaptation, recovery, and consolidation.

Welfare State and Production Regimes

In his path breaking work on social policy regimes, Esping-Andersen argues that (1) welfare states vary along multiple dimensions and (2) they cluster around three distinct regimes. While subsequent work on the welfare has disputed varying aspects of Esping-Andersen's argument[2], his typology has proved to be a highly useful heuristic explanatory device which we adopt, with a few modifications. First, following Castles and Mitchell (1993), we distinguish an Antipodean type of "wage earner welfare states" (Table 1). While these two countries have converged on the liberal welfare states since the beginning of the era of retrenchment which we somewhat arbitrarily date as commencing in 1980, they were quite distinctive at this point in time. Second, we label his conservative/corporativistic group "Christian democratic". This labeling is consistent with the "liberal" and "social democratic" labels in that it underlines the main political force behind the creation of these welfare states. More important, the label gets away from the misleading implication of Esping-Andersen's work, namely that the "conservative" welfare states of continental Europe reinforce inequalities created in the market and thus preserve the stratification system.

We leave it as an open question how clearly countries clustered into four distinct types.[3] We do contend that within a given country, different aspects of the welfare state "fit" together and "fit" with different aspects of the production regimes, in particular their labor market components. This "fit", however, is not a one-to-one correspondence between a whole configuration of welfare state and production regimes. Rather, an essentially similar set of inter-enterprise and employer, labor, and government relationships can be the framework within which different specific - not any - welfare state regimes emerge. Conversely, the same welfare state regime is compatible with different—though not any—labor market institutions and policies. The groups themselves vary in their homogeneity, with the Scandinavian social democratic group being the most homogenous and the continental Christian democratic being the most heterogeneous, particularly if one includes production regimes into the analysis.

The data in Table 1 outline the basic differences between policy and institutional configurations in the different types of welfare states. All data are for 1980 or the closest possible year and thus represent a cut in time before significant retrenchment occurred in all but a few cases. The first two columns document, in conjunction with the implicit absent category (years of secular center and right cabinet), the differences in the political underpinnings of the groups.[4] The Scandinavian countries were distinguished by years of social democratic governance.[5] Liberal welfare states were characterized by the absence of a Christian democratic government and, with the exception of Britain, little or no influence of social democracy in government. The "wage earner" welfare states were characterized by strong Labour parties, who nonetheless were narrowly defeated in most elections between 1945 and 1980, and by strong unions (see Table 2). Thus, the Antipodean labor movements relied on "social protection by other means", that is, through highly regulated labor markets (Castles 1985). Since the Christian democratic welfare states were the most heterogeneous, we have broken them down into three subgroups. The first "group" contains the lone country of Austria. It is the only Christian democratic welfare state in which social democracy is more influential than Christian democracy. Its production regime, particularly relations between capital, labor, and the government, and to a lesser extent its labor market policies, were closer to the social democratic model than to the Christian democratic. In the next group, Belgium, Netherlands, and Germany, social democracy was influential but not as influential as Christian democracy. Like Austria, these countries also were more generous than the other three Christian democratic countries on most of the welfare state indicators in Table 1. These countries also shared—to different degrees—production regime characteristics with the Nordic economies which set them off from the other three countries in the Christian democratic group.

As one can see from the table, both the Christian democratic and social democratic welfare states were much more generous than the other groups in terms of their social expenditure (columns 3, 4, 7). Indeed, it would appear that the Christian democratic welfare states actually provided more generous transfer payments than the social democratic welfare states. While it is true that they spent more on transfers and they were "transfer heavy" as compared to the "service heavy" social democratic welfare states (Huber, Ragin, and Stephens 1993, Huber and Stephens 1996), the transfer spending figures in Table 1 for Christian democratic welfare states were high in part because the target populations (the unemployed and people on early retirement) were large.

Esping-Andersen's decommodification index (column 11) is a better indicator of the generosity of transfer entitlements than the transfer expenditure figure. It is a composite measure of the characteristics of three income transfer programs (pensions, sick pay, and unemployment compensation), the components of which are various measures of qualifying conditions and benefit duration and income replacements for two categories of workers, a "standard production

worker" and those qualifying for only minimum benefits (Esping-Andersen 1990: 49, 54). One can see from the index that social democratic welfare state transfer systems were more generous than the Christian democratic ones. Other data from the Social Citizenship Indicators Project at the University of Stockholm, and other sources, indicate that a principal reason for the difference, as manifested by the index, between the social democratic and Christian democratic welfare states was that income replacement rates among those with minimum qualifying conditions were much better in the Nordic countries (Palme 1990, Kangas 1991, Carrol 1994, OECD 1994).

It was not, however, in the structure of transfers that the social democratic welfare states and Christian democratic welfare states differed most. As we have shown in an analysis of pooled times series data, the most distinctive feature of the social democratic welfare state was the public funding and delivery of social services (Huber and Stephens 1996). One can see the dramatic differences in this regard from the figures for public health, education, and welfare employment as a percent of the working age population in column 6 of Table 1. In the case of health care, it is clear from a comparison of the figures in columns 7 and 8 that other welfare states pick up the tab for health but are not the primary deliverers of it. Outside of the Nordic countries, only three other countries, the UK, New Zealand, and, from 1978, Italy, had national health services and in two of these (UK and New Zealand), they were products of social democratic governments. The expansion of additional social programs—day care, elderly care, job training programs, temporary employment programs in the public services, after school programs, to name a few examples—along with improvement in maternal and parental leave programs, were the main areas of welfare state innovation in the Nordic countries in the 1970s and 1980s. The difference in the level of public social services was the reason why taxation levels in social democratic welfare states were significantly higher than in the Christian democratic welfare states, averaging close to 49% of GDP compared to 42% in the latter group (Table 1, column 5) despite the fact that transfer payments were actually lower on the average in the social democratic welfare states.

Two distinctive features of the social service intensiveness found in the social democratic welfare states are worth underlining. First, they were "women friendly" and promoted the expansion of women's labor force participation which we examine below. This is reflected in the index in column 12 which measures the extent to which a wide range of social provisions facilitate the entrance of mothers with young children into the labor force. Second, they were aimed at the non-aged, as can be seen from the OECD figures on spending on the non-aged as percent of GDP in column 10 of Table 1.6. In both cases, these distinctive features involved investment in human capital and in the mobilization of labor.

Turning now to the relationship between welfare state and production regimes, we take as our point of departure Soskice's (1994) conceptualization but add a more explicit treatment of the role of the state. Soskice emphasizes employer organization and relationships between companies and financial institutions as defining characteristics of production regimes. Employer organization takes three distinctive forms: coordination at the industry or sub-industry level in Germany and in most Northern European economies (industry-coordinated market economies); coordination among groups of companies across industries in Japan and Korea (group coordinated market economies); or the absence of coordination in the deregulated systems of the Anglo-American countries (uncoordinated market economies). He notes that France was an example of a different type of production regime because the state played the leading role. In coordinated economies, employers are able to organize collectively in training their labor force, sharing technology, providing export marketing services and advice for R&D and for product innovation, setting product standards, and bargaining with employees. The capacity for collective action on the part of employers shapes stable patterns of economic governance encompassing a country's

financial system, its vocational training, and its system of industrial relations.

A central characteristic of the coordinated economies is the generalized acceptance by all major actors of the imperative of successful competition in open world markets. Successful competition in turn requires a high skill level of the labor force and the ability of unions to deliver wage restraint to the extent needed to preserve an internationally competitive position. In the industry-coordinated market economies of Central and Northern Europe, initial labor skills are effectively organized in companies or with strong company and union involvement in public schools. Unions are organized mainly along industrial lines and play an important cooperative role in organizing working conditions within companies and in setting wage levels for the economy as a whole. Banks and industries are either closely linked, providing industries with preferential sources of long term credit, or the state plays a major role in bank ownership and performs a similar role in preferential credit provision for industry. In uncoordinated market economies, in contrast to both types of coordinated economy, training for lower level workers is not undertaken by private business and is generally ineffective. Private sector trade unions are viewed as impediments in employer decision making, have little role in coordinating their activities, and are weak. Bank-industry ties are weak and industries must rely on competitive markets to raise capital.

While Soskice's analysis focuses heavily on factors underpinning competitiveness in manufacturing and on the organization of capital and labor, these institutional frameworks can be seen as national and/or economy-wide (see Kitschelt et al. 1998). They are further differentiated by the extent of state involvement in capital and labor markets. With this extension, one can distinguish a Nordic pattern in which there was economy-wide bargaining and a large state role in economic management from the continental pattern in which bargaining was generally carried on at the industry level and the state's role was more muted. In the social democratic welfare states and Northern tier of Christian democratic welfare stares, the combination of strong unions and dependence on competitive exports necessitated a policy of wage restraint and the centralization of unions, employers' organizations, and the bargaining process made such a policy possible, with the temporary exception of the Netherlands. The unions' "side payment" for wage restraint, at least up to the mid-1970s, was full employment and the development of the generous welfare state described above.

In the case of the Nordic countries and Austria, fiscal and monetary policies were moderately counter-cyclical and backed up by occasional devaluations.[7] The core of long term growth/employment policy, however, was a combination of supply-side and tax policies which themselves largely affected the supply side. Key among the supply-side policies were an active labor market policy (though in Austria only from the 1970s on), regional policies, and support for selected industries. Tax policies heavily favored reinvestment of profits over distribution and industrial investors over consumers. Interest rates were kept low through credit rationing, state supply of cheap credit, and through public sector surpluses. These policies were predicated on financial controls. In addition, fiscal policy was generally austere: these countries usually ran budget surpluses. The demand side of the growth/employment models in these small countries was only in part internally generated; it was, to a greater extent, a result of demand for exports created by the vigorous post war growth in the core advanced capitalist economies of North America and Europe.

Table 2 outlines some of the parameters of the production regimes, particularly labor market institutions, corresponding to the welfare state types. Given that at least some strands of the literature on corporatism consider social democratic government to have been a precondition for corporatism (Western 1991), it is not surprising that countries with social democratic welfare states were highly corporatist as indicated by Lehmbruch's (1984) scale of corporatism (column

4). The countries with Christian democratic welfare states, particularly the four countries of the Northern tier, were also highly corporatistic. However, if one wants to draw a distinction between the formal institutional features of corporatism and the effective participation of labor in the sense of exercising significant influence through these institutions, then one could not classify the Netherlands as equally strongly corporatist as Sweden, Norway, and Austria.

Union organization and coverage were very high in the social democratic countries and only slightly lower in the wage earner welfare states. While union density was lower in the Christian democratic countries, coverage of union contracts was quite high due to agreements between employers and unions which extended union agreements to non-unionized workers, or to government legislation which achieved the same end. Wage setting was also very centralized in the social democratic and wage earner welfare states, and very decentralized in the liberal welfare states, with the Christian democratic welfare states falling in between. However, just as in the case of corporatism, one must be careful in ranking countries in terms of bargaining centralization on the basis of formal institutional arrangements only. On the Wallerstein (forthcoming) measure (column 5), both Austria and Germany appear to have had relatively low wage setting centralization. If one looks at the locations where collective agreements were signed, this is plausible, as in both countries agreements were signed at the industrial level and not at the national level. However, as Soskice (1990) makes clear, one must distinguish between the degree of centralization of bargaining institutions and the degree of co-ordination of wage setting. In Germany as well as in Austria, there traditionally was a high degree of economy-wide co-ordination of wage setting, more formal in Austria and more informal—but not less effective—in Germany.

As a result of the differences in union organization, bargaining centralization, wage setting, and union contract coverage, wage dispersion was much greater in the liberal welfare states than in the social democratic states. The Christian democratic welfare and the wage earner welfare states fell in between, but in this case they were closer to the social democratic group.[8] In fact, other than in Austria, wage dispersion in the Northern tier countries was similar to that in the Nordic countries.[9]

The social democratic welfare states were very different from the Christian democratic welfare states, including the Northern tier, and the wage earner welfare states in terms of women's labor force participation. As a result, they also differed in the levels of total labor force participation of the working age population. The high level of women's labor force participation was both a result and a cause of the Nordic welfare state/labor market pattern (Huber and Stephens 1996). The growth of women's labor force participation, beginning in the 1960s, stimulated demands by women for the expansion of day-care and other social services which, along with social democratic governance, helped fuel the growth of public social service sector employment. These public social service jobs were filled very disproportionately by women, and this in turn stimulated a further expansion of women's labor force participation. The continental Christian democratic welfare states followed a quite different trajectory. Foreign labor was imported in large numbers, a policy arguably due to Christian democratic emphasis on the traditional male-breadwinner family and weaker union influence on labor recruitment policies. Moreover, in these countries, union contracts covered a large proportion of the labor force, which prevented a rapid expansion of a low wage service sector, a source of employment for women in liberal welfare states (Esping-Andersen 1990). As a result women's labor force participation was the lowest in the continental Christian democratic welfare states of the three welfare state types, despite the fact that social policy is more "working mother friendly" in the Christian democratic than the liberal welfare states (compare column 1 of Table 2 with column 12 of Table 1).

As a result of these labor market configurations, then, both social democratic and Christian

democratic welfare states did not produce the dualist labor markets with a low wage sector, largely though not entirely in services, a characteristic of the liberal welfare states.[10] This "fits" with the generous welfare states of these countries and with an overall "high road" economic strategy, based on high quality/ high wage manufacturing for export, and thus with the type of production regime these countries have.

As we pointed out above, adding characteristics of the production regime to the analysis challenges the assumption that countries follow clear patterns and form neat clusters. So, for instance, while most of the Christian democratic welfare states of continental Europe were coordinated market economies, Soskice points out that the Netherlands and Italy only partly fit this designation and France had a state-led production regime. Denmark had different inter-firm relations from, and relied much more on small to medium firms for export than do the other Scandinavian countries, yet it developed a social democratic welfare state regime. Rather than abandoning the typology of welfare states and production regimes altogether, our solution is to treat the types as ideal types to which countries more or less conform. Moreover, we would contend that within each country, certain—though not all—aspects of its welfare state and production regimes do "fit" each other. Specifically, wage levels and benefit levels have to fit, and labor market and social policies have to be in accord such as not to create perverse incentives. In addition, the type of production for the world market has to fit with the qualification of the labor force and with wage and benefit levels. Business, labor, and government coordination in R&D, training, and wage setting makes it possible to engage in high quality production and thus to sustain high wages and a high social wage.

The production regimes of the wage earner welfare states were quite unique. As we mentioned above, this type of welfare state regime delivered social protection primarily through the wage regulation system which provided a male breadwinner wage and a number of social benefits to the wage earner. It was developed early in this century in an explicit compromise in which industry received protection and was enabled by the transfer of resources from a highly productive primary product export sector.

The combined welfare state regimes and production regimes, particularly their labor market aspects, result in very large differences in the distributive outcomes in the three groups of welfare states, as one can see from Table 3.11. The differences in income distribution after direct taxes and transfer payments between the social democratic welfare states and the Northern tier of Christian democratic welfare states and the other countries were particularly striking (column 1). These figures do not include the distributive effect of free or subsidized public goods and services which would increase equality in all welfare states (Saunders 1994), but particularly in the social democratic welfare states.

Columns 4-6 of Table 3 document differences in poverty levels in countries with different welfare state regimes. Poverty is defined as less than 50% of median income in the country in question. It is again clear that the social democratic welfare states did very well in combating poverty and the liberal welfare states very poorly. The Northern tier of Christian democratic welfare states were almost as effective as the social democratic welfare states (though again one has to observe that free or subsidized public goods and services are not included in these figures). Crossnational differences in disposable income inequality were in part a product of variations in market income inequality and these in turn are in large part a product of wage dispersion and unemployment levels. From Tables 2, 3, and 4, one can see that part of the reason for egalitarian outcomes in the social democratic welfare states and the Northern tier of Christian democratic welfare states lies in the fact that these countries had compressed wage differentials or low unemployment, or both, in the early Eighties.

As to the redistribution effected by taxes and transfers, Korpi and Palme's (1998) analysis

demonstrates that the systems which combine "basic security", a term that usually refers to transfers with flat rate benefits, and "income security", transfers with earnings related benefits, have the greatest redistributive impact. The Nordic pension systems which combined a flat rate citizenship pension and an earnings related supplement are good examples of this type. Korpi and Palme point out that most other programs, and thus the Nordic welfare states as a whole, had this structure. In contrast to the social democratic welfare states, entitlements in the Christian democratic welfare states were almost entirely employment based and earnings related. They generally lacked the basic security tier; the task of meeting the needs of those outside the labor market falls to means tested benefits. What is very surprising, so surprising that Korpi and Palme (1998) term it the "paradox of redistribution," is that the Christian democratic welfare states with their great reliance on employment-based, earnings-related benefits were more egalitarian in their impact than the liberal welfare states with their greater reliance on programs targeted to the needy. That this is true can be readily seen from Table 3. Part of the explanation, Korpi and Palme argue, is that the Christian democratic welfare states were simply much larger: though their benefit structures were less egalitarian, they more than make up for it in greater expenditure. In addition, where benefits are generous, they tend to squeeze out private alternatives as can be seen from column 9 of Table 1 (see Kangas and Palme 1994, Stephens 1995). As Kangas and Palme show, these private alternatives are invariably much more inegalitarian than the most inegalitarian of public pension systems (the Finnish).[12]

As to the policy measures which are most effective in combating poverty, we can give more precise answers, particularly with regard to the two groups most vulnerable to poverty, the aged and single mothers. Palme's (1990) data on minimum pensions for the early Eighties make it abundantly clear that the level of minimum pensions was the main factor accounting for the international differences in poverty levels among the aged. As for single mothers, the two factors which appear to explain the most variation in poverty rates are child allowances and high levels of labor force participation among young women which is in turn a product of policies supporting mothers' employment (Watson 1996, Gornick et al. 1998).

For the working age population, pretax/transfer distributive outcomes produced very low levels of poverty in the three Nordic countries for which we have data due to the low levels of wage dispersion and low levels of unemployment from the early Eighties on. For those dependent on transfers, unemployment compensation and social assistance are obviously important measures for poverty reduction. Since child allowances are generally flat rate and in no case vary directly with income, they are also an effective means of combating poverty, not just among single mothers but among all low income families.[13]

Table 4 outlines the performance of the different countries, again grouped by welfare state regimes, in growth and employment. As the table indicates, it is difficult to maintain that the generous social democratic and Christian democratic welfare states have been a clear drag on economic growth or unemployment levels. A more complex argument might be made in which it is claimed that generous social policy and high taxes produce micro level disincentives which are a drag on growth, but then the associated production regimes provide contrary incentives which more than make up for the disincentives.[14] Both the social democratic and Christian democratic welfare states were built in economies very open to trade and, especially in the social democratic welfare states, they were built around the interest of the export sector workers whose unions were the dominant force within their respective union movements. These workers and unions had, and have, strong interests in the competitiveness of the export economies of their countries. These countries chose a high-road niche in the world economy based on highly skilled and educated labor, cooperative production, and capital intensive production techniques, which is compatible with both high wages and generous social benefits.

Welfare State Retrenchment and Changes in Production Regimes Since 1980

In our quantitative and comparative case work on welfare states in the era of retrenchment (Huber and Stephens 1996; n.d., chapters 6 and 7; Stephens, Huber, and Ray 1998), we find that rollbacks and "restructurings" in welfare state programs have been a universal phenomenon in the past two decades. We distinguish "restructuring" from rollback as some programs, most significantly public pension systems, have been significantly restructured in a fashion in which the benefits have not been significantly cut but contributions or taxes have been increased to make the pension systems viable.

Indeed, pension systems have a special dynamic and because they are dealt with at length in Myles and Pierson (forthcoming), we will simply make a few observations on the antecedent causes of changes in pension system. As Myles and Pierson (forthcoming; Myles 1997) point out, the pressures on pensions systems were created by a combination of demographic and economic change. As a result of increasing longevity and declining birth rates, the populations of advanced industrial democracies have aged and will continue to do so as the post-WWII generation moves into retirement. The decline in wage growth and increase in the returns on capital in the present era as compared to the Golden Age made the PAYG (Pay-As-You-Go) systems designed in the previous era unviable, and made more fully funded systems more attractive alternatives. We would add that, to the extent that financial internationalization has contributed to slower wage growth and higher interest rates as we will argue below, it contributed to the pressures to restructure the pension systems.

As to actual cutbacks—reductions in social benefits and social services—our case studies indicate two different dynamics: ideologically driven cuts, which occurred in only a few cases, and unemployment driven cuts, which were pervasive. It is the timing and severity of the latter type of rollbacks that argues that they were largely unemployment driven. The countries where unemployment rose early (Denmark and the Netherlands) initiated cuts in the mid-1970s; the countries where unemployment rose late (Sweden, Norway, Finland) continued to expand welfare state entitlements until the late 1980s. The countries where unemployment levels remained very high for a long time (e.g. the Netherlands) made deeper cuts than the countries where they remained more moderate (e.g. Norway). This is not to say that all the policy changes were somehow dictated by economic constraints; perceptions and beliefs about the effectiveness of different policies in achieving certain goals did play a role. Thus, the rising hegemony of neoliberal doctrines certainly contributed to the rollbacks.

In most cases, these rollbacks did no more than reduce the increase in welfare state expenditures. In fact, if we look at the aggregate data for the different welfare state types, the average annual increase in most indicators of welfare state expenditures in the Seventies was higher than it had been in the Golden Age, and it continued to increase in the 1980s, though at a slower pace than in the previous two periods. Essentially, in the 1970s governments countered the deteriorating economic situation with traditional Keynesian counter cyclical policies, but by the 1980s they had all realized that the rules of the economic game had changed and demanded new approaches. Nonetheless, the increase in claimants of benefits kept pushing up expenditures.

Generally speaking, retrenchments began with lags in adjustments of benefits to inflation and increased co-payments for welfare state services, particularly health care. The data on public share of total health care expenditures reflects these economizing measures: the average annual increase in the public share was already lower in the 1970s than in the earlier period, and in the 1980s the public share declined. Increases in waiting days for benefits, decreases in the length of time for which the most generous benefits could be claimed, and decreases in replacement rates followed. Eligibility criteria for a variety of programs were stiffened, particularly for

unemployment and disability benefits. In the case of pensions, cuts in benefits promised for the future but not yet enjoyed by retirees were implemented in some countries. Thus, though retirees will enjoy equal or higher benefits in the future than in the present, they will not enjoy the benefits they would have enjoyed under previous legislation.[15] Only rarely were entire programs abandoned or radically changed, such as in the example of maternity and death grants and the child benefits in Britain, or the universal health care system in New Zealand. Nevertheless, the cumulation of all these changes meant, in some cases, a significant reduction of entitlements, though not a system shift.

Our data show a sharp decline in partisan effects on welfare state expansion/retrenchment, with one important exception: public social service employment. Curtailment of entitlements, or at best defense of existing entitlements, was on the agenda everywhere. As Pierson argues (1996, also see Huber and Stephens 1993, 1998), the politics of retrenchment are different from the politics of welfare state expansion. The right was constrained in its ability to cut by the popularity of most of the large welfare state programs, and the left was constrained in its ability to raise taxes to keep the programs on a sound financial basis by the economic slowdown. This is not to say that there have not been significant differences in the rhetoric of political parties with regards to desirable welfare state reforms, but simply that electoral constraints worked against radical departures from established welfare state models In our data analysis, the only indicator on which we found continued partisan effects was public employment, a result which was driven by the expansion of the public social service sector in Scandinavia that continued throughout the 1980s. As the unemployment crisis hit Scandinavia in the early Nineties, the expansion of public employment ceased.

There were only a few cases of large-scale ideologically driven cuts. The most dramatic were Thatcher in Britain, the National (conservative) government in New Zealand, and the Reagan administration in the United States. In the case of the Reagan administration, the cuts were focused on cash and in kind benefits to the poor, a small but highly vulnerable minority, while Social Security was preserved by a large increase in the contributions made to it. The United States cannot have been said to have made a "system shift" if only because it already had the least generous welfare state of any advanced industrial democracy. Only in Great Britain and New Zealand could one speak of an actual system shift from welfare state regimes that used to provide basic income security to welfare state regimes that are essentially residualist, relying heavily on means-testing. We argue that the exceptional nature of these two cases can be traced to their political systems which concentrate power (unicameral or very weakly bicameral parliamentary governments in unitary political systems) and make it possible to rule without a majority of popular support (single member districts and plurality elections which allow parties with a minority of votes to enjoy large parliamentary majorities). Thus, in both cases, the conservative governments were able to pass legislation which was deeply unpopular.

Despite these common trends to retrenchment and the rarity of ideologically motivated rollbacks, there were very important differences between welfare states in how they handled the higher unemployment. Such differences reflected the type of welfare state regime. They become visible if one looks at activity rates. The well developed Christian democratic welfare states attempted to deal with unemployment by decreasing the labor supply. Older workers were helped into early retirement or provided with disability pensions. For example, labor force participation among male workers in the age group 60-64 fell from around 70% to 22% between 1973 and 1991 in the Netherlands (Hemerijck and Kloosterman 1994). In the well developed social democratic welfare states, in contrast, active labor market policies were used to keep up employment. Thus, in 1994 at the peak of the Nordic crisis, labor force participation among males aged 55-64, was at 64% in the four Nordic countries as compared to 42% in five Christian

democratic welfare states for which there is comparable data (OECD 1996b: 34).[16]

If we look at total activity rates, including those for women, the differences become even more pronounced. As noted above, the only large welfare state expansion in the Eighties was the expansion of public social services in Scandinavia. Since most of these jobs were filled by women, female labor force participation continued to expand during this decade. This expansion was facilitated by other social reforms, such as expanded parental leave provisions. As a result, by 1993 an average of 72% of women worked in the Scandinavian countries, as opposed to only 54% in the countries with Christian democratic welfare states. This made for much more favorable ratios of the total working to non-working population in the former compared to the latter (see Table 2).

Given the crucial role that the rise in unemployment has had in stimulating welfare state retrenchment, we have to seek to understand the reasons for the dramatic increases in unemployment in the Eighties and early Nineties (see Table 4). Here we can only summarize the arguments we make elsewhere at length (Huber and Stephens 1998, Stephens 1996, Huber and Stephens n.d., Chapters 6 and 7). First let us dispense with the standard argument that regularly appears in the *Economist* and in European reporting by the *New York Times*, that with globalization, countries with generous welfare states and high wages were increasingly exposed to trade competition and their generous social provisions made them uncompetitive in ever more open world markets. In fact, the generous welfare states of Northern Europe were developed in very trade-open economies in which the performance of the export sector was pivotal for the economic welfare of the country. Moreover, the export sectors of countries such Sweden and Germany were performing incredibly well in the mid-Nineties, that is, at precisely the same time when the governments of those countries were cutting social benefits (Huber and Stephens 1998; Pierson, forthcoming; Manow and Seils, 1998). Thus, it is clear that export competitiveness was not the cause of the retrenchment, at least not as a direct economic constraint. The issue did lend itself to effective rhetoric from the right and business and may have made an indirect contribution to legitimizing cuts (see Swank PEEI).

Underlying the growth in unemployment would appear to be a decline in the growth of employment which in turn could be attributed to the decline in economic growth. Per capita growth rates did fall from 3.8% in the period 1960-73 to 2.6% in the Eighties. However, as Glyn (1995: 2) points out, it is not true that employment growth in the OECD was significantly faster in the period 1960-73 than in 1973-93.[17] Of course, many of the jobs produced in the Eighties were part-time jobs. This must be considered if we are concerned with increases in citizens' well-being, but conventional unemployment rates count part timers as employed so this cannot explain the increase in unemployment. As Glyn observes, the data show conclusively that observers who explain the current problem as one of "jobless growth" miss the mark completely. While this may be true of manufacturing, if anything the opposite is true of the economy as a whole: given that average annual per capita growth was significantly lower in the post 1973 period (see Table 4), these economies were clearly producing more jobs for each percent of growth than they were in the Sixties.

This counterintuitive finding is explained by the sectoral changes in the economy correctly pointed to as a main source of lower growth rates in the contemporary period by Iversen (forthcoming) and Pierson (forthcoming, also see Maier 1985). As sectoral composition of the economy has shifted from the high productivity growth manufacturing sector to the lower productivity growth service sector, growth has declined. By the same token, each per cent increase in growth results in a larger increase in employment precisely because of the greater labor intensity of services. While we would agree with the contention that the lower growth rates caused by the sectoral shift have had a direct impact on social policy because higher growth rates facilitate the

simultaneous expansion of private and public consumption, the sectoral shift has not exerted pressures on the generous welfare states by causing increasing unemployment.

Since the growth of the working age population is actually lower in the period after 1973 than before, it must be that rising participation rates explain the rise in unemployment. Glyn correctly observes that this goes far in helping us to explain the secular trend within countries, but is of more limited use in explaining the differences between countries. From Tables 5, we can see that in the earlier period the entry of women into the labor force was entirely offset by the exit of men from the labor force. Since this was an era of full employment, it is a good guess that the exit of men was almost entirely voluntary and due to the lengthening education and declining retirement ages. By contrast, in the more recent period, women have entered the labor force at double the rates that men have exited. Moreover, we know that in this period, a significant portion of the exit of men was involuntary as they were forced into early retirement by high unemployment. With regard to the pattern across countries, only within the Christian democratic group do variations in participation rates of men and women give one much leverage in explaining variations in rates of unemployment. In Switzerland and Austria, the small increase in women's labor force participation was counterbalanced by declines among men, which helps explain why these two countries fared better in their unemployment rates than the other countries in this group. In the social democratic welfare states, the big increase in women's labor force participation occurred while these countries maintained close to full employment.

The change in the sectoral composition in the labor force is not the only cause of the decline in growth rates after 1973. Unlike sector change, these other changes which have affected growth do not appear to have automatic counterbalancing effects on unemployment. We would argue that, *ceteris paribus*, higher growth rates would have produced more jobs and less unemployment, and that one of the key requirements for higher growth would have been higher investment levels. Many economists argue that capital stock has no impact on unemployment and inflation, and that the problem of job creation is to be solved through the stimulation of more employment on existing capital stock by making labor markets more flexible. However, as Rowthorn (1995) argues forcefully, there are good theoretical reasons and strong empirical evidence linking the growth of capital stock to growth of employment. He works within a non-accelerating inflation rate of unemployment (NAIRU) framework and assumes no central coordination of wage and price setting. In his model, additional capital stock reduces the inflationary conflict over income distribution and thus allows the NAIRU to stabilize at a lower level. Growth in capital stock causes productivity growth which in turn permits growth in real wages and reduces the saliency of the struggle over the share of labor versus capital income. His model works in the context of non-coordinated bargaining, and it is even more plausible that the labor market partners in a coordinated economy would take advantage of higher growth rates to opt for relative wage restraint in the interest of higher investment and employment levels. Empirical support for these arguments is provided by a regression analysis estimating the effects of growth in capital stock between 1960 and 1992 in ten OECD countries on employment, which shows a large, statistically significant effect (Rowthorn 1995: 33-4).

Our own data show a fall of gross fixed capital formation from 24% of GDP in the Sixties to 21% of GDP in the Eighties. Three important immediate causes of this decline in investment are a decline in the rate of profit on productive investment, a decline in net savings (from 14.4% of GDP in 1960-73 to 9.1% in the Eighties and then down to 7.7% 1990-93), and an increase in real interest rates (from 1.4% to 3.8% to 5.6% in the three periods) (OECD 1995: 77, 108).[18] The deregulation of international and domestic financial markets is partly responsible for this increase in interest rates.[19] As a result of the elimination of controls on capital flows between countries, governments cannot control both the interest rate and exchange rate. If a govern-

ment decides to pursue a stable exchange rate, it must accept the interest rate which is determined by international financial markets. As a result of decontrol of domestic financial markets (which was in many cases stimulated by international financial deregulation), government's ability to privilege business investors over other borrowers also became more limited.

In fact, the coordinated market economies, most of which relied on some form of capital controls, experienced a significant decline in gross fixed capital formation from the 1960s through the 1980s, whereas the liberal market economies experienced no such decline. Nevertheless, the level of gross fixed capital formation in the CMEs remained above that of the LMEs. [20] In Germany, where capital controls were not a factor, financial internationalization has also had a negative effect on the traditional model of investment financing, in so far as the special long-term relationships between banks and corporations are becoming weaker (Streeck 1997, Manow and Seils 1998).

External financial decontrol also limits a government's ability to employ fiscal stimulation as a tool, as fiscal deficits are considered risky by financial markets and either require a risk premium on interest rates or put downward pressure on foreign exchange reserves. Thus, at least a portion of the increase in unemployment can be linked to globalization in the form of deregulated capital markets. However, it is important to recognize the importance of political decisions and conjunctural developments in explaining the current high levels of unemployment in Europe. Though it almost certainly was not a conscious decision, or at least not seen in these terms, the Christian democratic welfare states, faced with a growing supply of (female) labor, rejected the alternatives of creating a low wage market in private services along American lines or expanding public services (and thus raising taxes) along Nordic lines.[21]

When we talk about conjunctural developments, we don't mean to imply that these developments are necessarily cyclical and transitory; rather, we want to distinguish them from secular changes that are clearly irreversible. With regard to conjunctural elements of the present employment crisis in Europe, then, one can begin with the contribution of the debt build-up of the Seventies to the current high levels of interest rates. With only two exceptions, the countries included in our quantitative analysis increased expenditure faster, in most cases much faster, than revenue in the Seventies and then did the reverse in the Eighties, but not enough to erase the debt, and in many cases the deficits, inherited from the Seventies. This legacy, plus the development of the EMS, the collapse of the Soviet Union, German reunification, the Maastricht accord and the development of the EMU led, in sequence and in combination, to the extremely austere monetary and fiscal policy now prevalent in Europe (Hall 1998, Soskice, in press). With open financial markets and the EMS system of fixed exchange rates, interest rates in European countries were determined by financial markets and, given the pivotal role of Germany in the European economy, this increasingly meant that the Bundesbank set European interest rates, imposing its traditional non-accommodating policies on the rest of the region. The collapse of the Soviet Union and with it the Soviet economy sent a negative shock to all countries with exports to the Soviet Union, a shock which was a major blow to the Finnish economy and a minor one to a number of others. The budget deficits caused by German reunification stimulated an exceptionally austere response on the part of the Bundesbank which was then communicated to the rest of Europe.[22] The convergence criteria contained in the Maastricht accord imposed further austerity on all governments, even those not committed to becoming EMU members, such as Sweden, and even on those outside of the EU, such as Norway.

In the cases of Finland, Sweden and, to a lesser extent, Norway, government policy mistakes strongly contributed to, indeed, may have created the crisis.[23] All three countries deregulated their financial markets in the Eighties which led to booms in consumer spending, skyrocketing real estate prices, and an overheated domestic economy and wage inflation. In the bust that fol-

lowed the boom, property values collapsed which caused bank insolvency and consumer retrenchment, which in turn aggravated the deep recession. The bank bailout cost the Swedish government 5% of GDP and the Finnish government 7% of GDP, greatly adding to the deficit in both countries.

The changes in the international financial system, and resultant changes in the setting of monetary and fiscal policy, fundamentally changed the wage bargaining process in Scandinavia, resulting in a convergence on the Northern European model.[24] As Iversen (1998) points out, there are two different ways in which CMEs can produce wage moderation and low unemployment. The first one, associated with Scandinavia, and Austria before 1973, combined centralized wage bargaining with accommodating monetary and fiscal policy and was associated with more nominal wage inflation than the alternative model. That model is best exemplified by Germany and it combined industry level coordinated wage bargaining with non-accommodating monetary policy and resulted in little nominal wage inflation. For this system to result in little unemployment it is necessary for the monetary authorities to send such a strong signal that inflation will not be tolerated that the labor market partners bargain with expectations of very low inflation. As pointed out above, the current monetary arrangements in Europe impose such a regime on all countries. Though this new system requires adjustments on the part of labor market actors, there is no reason to suppose that it cannot produce wage restraint and low unemployment in Scandinavia, as it has in Germany in the past. The apparent learning process in Sweden over the last two bargaining rounds (1995 was inflationary, 1998 moderate) supports this view.[25]

A final change in production regimes of the Nordic countries, of the continental European CMEs whose production regimes included an important role for state ownership and intervention (such as Austria and France), and of both of the Antipodean countries (but particularly New Zealand), has been a strong trend to privatization of state enterprises or the introduction of market mechanisms into the operation of not only state enterprises but also public administration. A key motive behind these moves in most cases has been fiscal retrenchment, with the sale of state enterprises giving the government a one shot deficit reduction and the rationalization of public enterprises to put them on a profit making basis resulting a much smaller but continuing boost to the budget. The immediate effect of privatization or marketization is increased unemployment as personnel kept on for non-economic reasons are laid off. The longer term effect is less clear. Arguably, the employment effects could be positive as the now profitable enterprises begin to invest and take on new employees.

In contrast to the European and North American cases, the production regimes of the Antipodes did undergo a system shift as a result of changes in the international economic environment. As a result of long term secular changes in commodity prices, the Australasian production regimes became unviable because they were based on rents transferred from the primary product sector to a protected manufacturing sector. These rents were highly adversely affected by these changes in international markets. In both countries, the wage regulation system, which was the core of the system of social protection, was changed substantially—in New Zealand, it was completely abolished—and this, along with the rise in unemployment, exposed workers to much higher levels of risk of poverty than had earlier been the case. Add to this other marketizing reforms (see Castles et al. 1996; Schwartz 1994a, 1994b, 1998), and it becomes apparent that the production regimes of the Antipodes have converged on the liberal type. However, there are strong differences between the two countries with regard to not only the extent of labor market deregulation but also changes in the social policy regime proper. In Australia, Labour attempted not only to compensate those hit hardest by the ongoing changes with targeted programs, it also introduced two universalistic policies, medical care and supplementary pensions,

which make the Australian social policy regime one of the most generous in the liberal group. By contrast, the conservative government elected in 1990 in New Zealand, unchecked by veto points in the country's unicameral unitary system, carried out deeply unpopular reforms which completely deregulated the labor market and substantially cut social benefits.

To conclude this section, let us summarize the main changes in production and welfare state regimes, their interrelationship, and their relationship to globalization. First, the changes in the production regimes are greatest in those countries which relied most on political control of markets, above all the Nordic countries, some of the continental CMEs, and the Antipodes. The rationalization of the public sector and privatization of state enterprises certainly contributed to the rise in unemployment in the short term, but the long term and future effects are less clear. Though the developments fit uneasily under the rubric of globalization, it is clear that changes in the international economy fundamentally changed the Antipodean production regimes, moving them into the liberal group. Deregulation of international and domestic financial markets represented a profound change for the CMEs, especially the Nordic countries and continental CMEs who relied on financial controls. It deprived them of instruments by which they delivered low-interest loan capital to business investors, and of stimulative fiscal and monetary countercylical tools. Financial deregulation along with the debt legacy of the Seventies contributed to higher interest rates and arguably lower growth across the advanced capitalist world in the Eighties. In this environment, only the Nordic welfare states managed to absorb the growing labor force participation caused by the inflow of women into the labor force, and this was accomplished by expanding public sector employment. In the Nineties, the conjunctural features affecting Europe as whole and the developments specific to the Nordic group are certainly much more important than longer term secular changes, such as globalization, sectoral change in the economy, and the rise in labor force participation, in explaining the additional rise in unemployment and thus welfare state retrenchment.[26]

Prospects for the Future

In this final section, we speculate about the future of development of the welfare state, particularly the prospects for the maintenance of the more generous and egalitarian Northern European welfare states, which the popular versions of the globalization thesis see as unviable. Our analysis is largely in agreement with Pierson's views on the impact of globalization (forthcoming). While the economic environment of the late Eighties and early Nineties was difficult for these welfare states, relatively little of this can be directly attributed to globalization as commonly understood (also see Swank, PEEI, forthcoming). Increased trade openness did not lead to retrenchment as these countries' economies have always been trade open and the export sectors continue to do quite well. It is true that increased financial openness made at least some contribution to the decline in growth by depriving governments of tools to encourage investment and to combat economic downturns. Moreover, it has contributed to the rise in real interest rates across OECD countries, though the debt and deficit burden inherited from the Seventies was also an important contributor here. Nevertheless, the most important sources of the employment crisis in Europe in the mid-Nineties, and thus of the pressures on the welfare state, have been (1) the failure of the Christian democratic welfare states to absorb the growing female labor force, (2) the failures of the Scandinavian welfare states to manage countercylical policy between the mid-Eighties and early Nineties, (3) the collapse of Soviet economy, (4) German reunification, and (5) the evolution of European monetary arrangements which have translated German austerity into European austerity (Soskice forthcoming). In addition, as many authors have pointed out, changing demographics have contributed to difficulties of pension and health care

systems. In our concluding remarks, we deal in turn with the future of the European conjuncture, the changing demographic burden, and national policies for increasing employment and growth. In connection with the latter, we address the OECD Jobs Study solution to the advanced industrial economies' employment problem.

It is perhaps most difficult to say anything about the future evolution of European monetary arrangements since nobody can say with much certainty what will happen.[27] Suffice it to make a few observation here. As our data show, almost all advanced industrial countries responded to the shocks of the Seventies with a large run up of debt, which appeared to be rational given the negative real interest rates prevailing at the time and the assumption that the industrial world was just facing a cyclical downturn rather than a fundamentally changed world. While virtually all governments, regardless of political coloring, realized in the Eighties that the world had indeed changed and began to increase revenue faster than expenditure, most of them did not do this fast enough to reduce deficits meaningfully by the end of the period of expansion, much less to reduce the accumulated debt. Thus, they were in a very bad position to meet to convergence criteria specified in the Maastricht accord.

In the cases of Sweden and Finland, the governments found themselves in a good budgetary situation at the end of the Eighties when the crisis hit, but they quickly began to record high deficits and skyrocketing debt. At the close of the Nineties, the situation looked much rosier for the social democratic welfare states of Scandinavia: by 1998, budget surpluses were recorded by all but Finland, where the deficit was under 2% of GDP; inflation was low; the latest wage round had delivered non-inflationary wage increases; and exports were doing well, in some cases booming. Only unemployment was problematic and even it was falling. In any case, given the budgetary situation, it could no longer be said that the countries could not afford their welfare states. In the Northern European Christian democratic welfare states, the Austrian economy continued to perform well and the turnaround in the Netherlands was being heralded as a "miracle" (Visser and Hemerijck1998), with unemployment falling to 6%. While the unemployment performance elsewhere in Europe was deeply problematic, almost all countries were moving toward reduced deficits under the pressure of Maastricht.

While the short term effects of the move to budget surplus across Europe are higher, probably much higher employment, the long term effect is to push continental Europe toward the traditional social democratic model of the Golden Age in which the social democratic countries ran budget surpluses across economic cycles which facilitated the supply-side, low interest rate policy pursued by these countries. Thus, though in the short to medium term, this means more unemployment, the longer term picture is not so bleak.

There is wide agreement that the demographic structure, the combination of higher life expectancy and declining fertility, is and will be a problem for welfare states, particularly those with a transfer and pensioner bias (Pierson, forthcoming; Esping-Andersen 1997). In the political discussion, this problem is often portrayed as a time bomb that is certain to destroy welfare states as we know them. However, the figures in Table 2 suggest that the increase in the aged dependency ratio will not be as dramatic as often claimed, and that there is considerable variation among countries. In Scandinavia, the changes for the worse in this ratio were larger in the past 30 years than they will be in the next 30; in the Continental European countries for which data are available, the decline in the ratio of active labor force age population to those 65 and over in the future will be somewhat steeper than it was over the past 30 years, and only in the liberal welfare states and the Antipodes will the decline be much greater.

Moreover, while it is true that the elderly are disproportionate burdens on welfare state services and transfers, the young are dependent (on education, child care, child allowances, etc.) also. If one includes them as part of the dependency ratio, then demographic change will be less

burdensome than is conventionally assumed. One can take this a step further. The relevant figure is not the ratio of dependents to adults but rather to those actually supporting the welfare state through employment and thus a contribution to the tax base. This figure, the ratio of the working population to the total non-working population (including the aged, youth, the unemployed, and adults not in the work force) is shown in the last three columns of Table 6. In this comparison, the social democratic welfare states do best, followed by the liberal welfare states, then the Antipodean, and finally the Christian democratic welfare states. Underlying these figures are the differing levels of women's labor force participation shown in Table 5. The two tables also underline another advantage of social democratic welfare states, not only are their active to non-active ratios very favorable, the demands on the economies to produce more jobs due to the entry of women in the labor force will decline in the future as these countries approach a situation in which the adult female population is fully active in the work force.

Female labor force participation clearly needs to be increased in the Christian democratic countries in order to increase the tax base of the welfare state. As Esping-Andersen (1996) points out, higher female labor force participation is needed not only to counteract a deterioration of dependency ratios resulting from an aging population and declining fertility rates, but also to reduce the household risk of falling into poverty resulting from the spread of non-traditional families and less stable labor markets. (All this is quite in addition to value-based arguments having to do with personal autonomy and power relations in the family.) In order to improve dependency ratios, of course, female labor force participation needs to be compatible with child-raising; if it is not, it will be accompanied by lower fertility. This suggests that the Christian democratic welfare states need to be adapted to these requirements and follow the Scandinavian model in the area of welfare state service expansion, particularly in the areas of child and elderly care. Given the demands of the EMU and the fiscal deficits of most continental countries, this does not appear to be a very likely avenue of reform since significantly expanding public employment would entail increases in expenditure and taxes. However, small steps in this direction might be taken, and other measures which do not increase the fiscal burden but would facilitate female labor force participation, such as changing the tax code to individual rather than household taxation, might be implemented.

On the other hand, when it comes to keeping people out of poverty, one should keep in mind that the Christian democratic welfare states are performing better than the liberal welfare states at present, despite the unfavorable active to inactive ratio. This is because they are embedded in production regimes with greater contract coverage and thus less inequality in the primary income distribution, and because of the greater generosity of their benefits. Thus, as we point out below, the liberal approach to dealing with the growing burden of an inactive population, deregulation of the production regime and transformation of the welfare state into a residual one, with the hope that the market will produce more low wage jobs, imposes sufficient social costs that it is unlikely that it will be pursued for political reasons. A more realistic goal, and in our view a more desirable one, is to increase the activity ratio within the parameters of the existing production and welfare state regime. As just noted, the obvious strategy to increase activity rates is to increase women's labor force participation by providing legal protection and services that make it easier to combine child rearing and working life. A second important strategy is the development of an active labor market policy with heavy emphasis on training and retraining.

This prescription, of course, raises the question where the jobs are supposed to come from that are to be filled by women entering the labor market. The recent success of the Netherlands and Denmark in lowering unemployment from double digit levels to around 6% suggests that wage restraint, which has been pivotal in both cases, will be a critical part of the model in CMEs. Our analysis in the last section suggests that policies to raise investment levels are a second ele-

ment of a strategy to create more employment. In what follows, we discuss the policies and prospects in both areas in sequence and then compare our jobs strategy with that of the OECD.

Developments in European monetary arrangements have imposed the equivalent of independent central banks pursuing non-accommodating monetary policy on all of Europe. As the work cited above indicates (Soskice 1990, Iversen 1998, Hall and Franzese in press, Soskice in press), the combination of central bank independence and coordinated industry level bargaining should yield effective wage restraint. According to Iversen (1998) countries with centralized bargaining (now only Norway and Finland) should have more difficulty in restraining wages because centralized bargaining is associated with wage solidarity policies which in turn is associated with wage drift. Here one must be more precise than Iversen and distinguish between what in the Swedish context is referred to as stage 1 (equal pay for equal work) and stage 2 of the wage policy of solidarity (wage compression between skill levels). We would argue that it is the skill-differential compressions which are problematic for wage restraint. Moreover, both the theoretical argument of Moene and Wallerstein (1998) and the empirical analysis of Hibbs and Locking 1996) indicate that, consistent with Rehn-Meidner arguments, the first stage of the Swedish solidaristic wage policy enhanced productivity growth whereas the second stage retarded it. The association of stage 2 with centralized bargaining is not as tight as that of stage 1, as the Finnish movement has never pursued it.[28] The latest wage bargaining rounds in both Finland and Sweden yielded moderate wage increases, so it is clear that centralized bargaining can produce wage moderation even in the present European monetary environment.

Our remarks in the previous paragraph indicate that there are reasons to give up wage compression policies and indeed this is what we have argued (Huber and Stephens 1998: 391-92). To the extent that the wage compression policy was actually successful, the inevitable result of abandoning it will be greater wage dispersion, as has occurred in Sweden since the end of centralized bargaining. Greater wage dispersion would, in turn, appear to result in greater inequality of disposable income, greater gender differences in income, and greater poverty. Therefore, abandoning wage compression would appear to be abandoning central goals of social democracy. The data available indicate that the loss would be minimal. As one can see from Table 2, with the exception of Austria, the differences in wage dispersion between Norway, Denmark, and Sweden and the other social democratic and Northern tier Christian democratic welfare state are not large.[29] Moreover, the differences in poverty levels of households whose head is aged 25-59, and in inequality of disposable household income, are yet smaller. The Austrian case is highly instructive as it combines moderate levels of wage dispersion with very equal levels of disposable household income.[30]

We noted above that one proximate cause of lower levels of growth in the post 1973 period was the lower levels of investment, and pointed out that the internationalization of capital markets has made it much more difficult for governments to stimulate investment. In countries in which corportatist bargaining arrangement have survived or could be revived, one possible way to encourage investment and secure wage restraint on the part of unions might be to make an explicit bargain exchanging wage moderation for domestic investment commitments of corporations. Given the internationalization of production, the commitment to domestic investment is essential lest wage restraint help finance investments elsewhere. The future obstacles to the achievement of such corporatist bargains resulting from a loss of interest on the part of employers in domestic class compromises are extremely difficult to gauge. On the one hand, company executives will increasingly follow the logic of the global interests of corporations. On the other hand, the advantages offered by the production regimes in coordinated economies, particularly high skill levels of the labor force, social peace, and policy predictability, may well sustain the interest of executives in the stability of these production regimes and their position in them.

Moreover, the world financial turmoil and recessions of 1997 and 1998 can be assumed to have strengthened the importance of home bases in the strategies of corporations headquartered in coordinated economies.

A proximate cause of lower investment has been the lower savings rate. As we have argued (Huber and Stephens 1998: 392-394), an extremely promising method of raising the savings rate is to fund or more fully fund social insurance. There has already been a trend in this direction in public pension systems in a few countries, notably Sweden and Canada (Myles and Pierson, forthcoming); this could be extended in the case of pensions and applied to other social insurance systems as well.[31] It would also have the advantage that it would make social insurance systems more solvent and thus more resistant to cutbacks in hard economic times.

A third potential path to investment stimulation is the lowering of payroll taxes in exchange for domestic investment commitments, which in turn entails reforming the financing and structure of social security schemes. Restructuring of social security schemes with some tightening of eligibility rules and a slight reduction of benefits is unlikely to produce the desired amount of savings, so that it needs to be accompanied by a shift to greater financing from general revenue. As the experience with social security reform in Continental Europe has shown, consent of unions is essential to make significant reforms work without major disruptions. Such consent is greatly facilitated by tripartite corporatist bargaining through which unions can be convinced that reform is indispensable and can be offered some measure of compensation. Whether these are traditional corporatist bargains or the new "competitive corporatist" bargains as conceptualized by Rhodes (forthcoming) seems to matter less than that the negotiations be inclusive, with wide representation of union and employer organizations.

This model of reducing labor costs through wage restraint and reduction of payroll taxes has been conceived largely to keep or make exports competitive, that is, with reference to the tradable sector. However, it can also be applied to the non-tradable sector, to both public and private service sector enterprises. Wage restraint in the public service sector can increase public savings and investments and, along with a reduction in payroll taxes, it can be traded off for investment commitments by private service enterprises. The effectiveness of reducing the state's contributions for public employees to the social security schemes, the equivalent of payroll taxes, is limited in terms of increasing public savings, of course, because of the need to find alternative sources of financing out of general revenue.

If one assumes that technological progress and productivity increases in the manufacturing sector will continue and thus keep the rate of job creation relatively low despite increased investment, one needs to look to the service sector as the major potential creator of jobs. The OECD Jobs Study has argued that low productivity growth in this sector means that these jobs must be low wage jobs (OECD 1994). The OECD strategy for creating jobs in this sector is to increase wage dispersion, deregulate labor markets, and cut social benefits, such as unemployment compensation, which raise the reservation wage. Thus, though based on a much more sophisticated analysis, the OECD formula is identical to that of conservative proponents of the globalization thesis. The American case with its large low-wage private service sector and current low levels of unemployment would appear to support the OECD's view. But there are reasons to be skeptical of (1) whether the US model was that successful and, if so, whether it was due to increased wage dispersion, (2) whether movement in this direction by the Christian democratic and social democratic welfare states would have large employment creation effects, (3) if they did, whether it would be worth the social costs of doing so, and (4) whether it is politically feasible for European governments to move in this direction even if it were deemed desirable.

On the first point, Freeman (1995) argues that if one adjusts the unemployment rates for the increase in incarceration, which has trebled since 1980, the US performance does not look so

outstanding. Western and Beckett (1998) have estimated that an inclusion of the prison population would raise unemployment levels among males by a negligible amount in Europe but by almost 2% in the United States. Freeman also presents extensive data demonstrating that increased wage dispersion in the United States did not contribute to employment growth. Still the OECD argument might be saved by contending that the pre-existing levels of wage dispersion, labor market flexibility, and low welfare state benefits were a precondition for the vigorous growth of the private service sector in the US.

On the second point, the experiences of the two countries which made the most dramatic moves in the direction suggested by the OECD, the United Kingdom and New Zealand, do not support the view that the American experience is replicable. Both countries have had modest upturns in employment recently but both are still above 6% unemployment and thus are not faring better than the Netherlands or Denmark. And they are paying the social costs paid by the US for some time now. Despite the decline in unemployment in the US, poverty increased modestly from 16.4% of households in 1979 to 17.9% in 1994, and inequality increased substantially, with the gini index for disposable income rising from the .31 shown in Table 3 for 1979 to .37 in 1994. The UK clearly moved to the American model in both respects as poverty increased from 5.7% in 1979 to 10.6% in 1995, and inequality increased from the .27 shown in Table 3 for 1979 to .35.[32] This increase in inequality was the largest recorded in the LIS data and moved the UK to a position second only to the US as the most inegalitarian country among the eighteen analyzed here. Unfortunately, LIS does not have data on New Zealand, but Easton's (1996) figures show very large increases in poverty and inequality in the early Nineties. Thus, New Zealand and the United Kingdom are paying the social costs while performing in terms of unemployment levels no better than countries such as the Netherlands and Denmark that have retained their generous welfare states and have experienced no increases in inequality and poverty. Fortunately, it is not likely that any other country in Europe would move as vigorously in the direction charted by the OECD jobs strategy as these two countries have because, as discussed in the previous section, the unique political conditions which allowed such unpopular policies to be implemented in these countries are not replicated elsewhere.[33]

If we reject the American way as codified in the OECD jobs strategy, we need to be able to identify policy options for creating service jobs with adequate wages and social protection. One option is expansion of social services in the public sector, where employees enjoy public sector working conditions. A second option is expansion of public funding of social services provided by the private sector, with working conditions determined by collective bargaining or by stipulations of minimum standards for firms bidding for contracts. Certainly, outside the Scandinavian countries there is much room for expanded social services, particularly in child care, elderly care, and continuing education. The obvious problem with both of these options is the burden on the government budget. However, if preceded by wage moderation as suggested above and accompanied by higher investment and—albeit modest—employment growth in manufacturing, the tax base will be enlarged and new resources will become available. A third option might be to stimulate productivity in the private service sector through support for R&D and skills training, a kind of "industrial policy" for the service sector. Certainly, in the area of business services this is feasible, as there are highly productive activities and firms there; the challenge is to extend this into the area of personal services.

One frequently suggested prescription for job creation is job flexibilization or job sharing, in the sense of creating more part-time positions and improving social protection associated with part-time work. Certainly from a social equity point of view, two people employed half-time are preferable to one employed full time and the other one unemployed. The question is to what extent this solution increases aggregate employment, productivity, and the value of goods and

services produced. Maybe the easiest positive answer can be given for productivity of labor. In most jobs, people are hard put to keep up maximum performance for eight hours; average productivity during a four-hour stretch is clearly likely to be higher. A second positive impact is the uninterrupted contact with the labor market and thus the continued employability of both workers, which should reduce frictional unemployment and thus increase the total number of hours worked. More hours worked and higher average productivity in turn will increase the total value of the goods and services produced in the society.

If there are indeed policy options to sustain generous welfare states and deal successfully with pressures on coordinated production regimes, what are the political conditions for their pursuit? Are we likely to see a return of partisan effects on social policy? Here we necessarily have to be extremely speculative and make one important assumption: that there not be any further economic shocks emanating in global markets. As long as unemployment crises dictated an agenda of curtailment of welfare state expenditures, the range of political choices was extremely restricted. Social democratic parties were forced to adopt austerity measures, and the constraints of blame avoidance kept centrist and right-wing parties from making very deep cuts. If we are correct that the cuts were mostly driven by unemployment and that at least some of the unemployment was cyclical, in some cases aggravated by policy mistakes, then we would assume that these pressures will relent as unemployment recedes from crisis levels, albeit still to levels above those of the Golden Age.[34] Weakened fiscal pressures as a result of more people working and contributing taxes, and fewer people claiming benefits, then introduce potentially new political dynamics. It will no longer necessarily be a politics of retrenchment. Nor will it be a return to the dynamics of welfare state construction; the welfare states in the social democratic and Christian democratic categories are fully developed, and the lower growth rates will keep resources comparatively scarce. Rather, it is likely to develop into a politics of rejuvenation and adaptation.

The notion of rejuvenation, as opposed to simple adaptation, captures a sense of innovation and initiative rather than a reactive adaptation to changing conditions. Creative initiatives will be needed to design future policies that can assure all members of a society full participation in professional, personal, and social life in accord with the standards of that society. Innovations will be called for in a number of areas. As women's labor force participation increases, the need for more women-friendly welfare state regimes will certainly arise in Christian democratic welfare state regimes. It is already pressing in liberal welfare state regimes. This entails not only the provision of services for children, but also a restructuring of various social insurance benefits that were built around the traditional male wage-earner family. If part-time work for both males and females is to increase, social security schemes will need to be altered to offer protection to part-time employees. As society gets older, with a growing proportion not just of people in retirement, but also of people over 80 years old, there will be a much greater need for support services targeted at the elderly. As life-long learning becomes more essential and careers may be interrupted repeatedly for additional training, support mechanisms for workers and families during such periods need to be constructed. This is not to be an exhaustive list of new issues for welfare state regimes to deal with, but it is to suggest a range of needs that are going to arise and to which there are potentially different approaches preferred by different political actors.

The basic choices to be made are whether the state should address these needs at all or leave their satisfaction entirely to individuals, families, private insurance, and collective negotiations between unions and employers. If the state is to play a role, two of the key issues are the financing system and the agents delivering the services. We would hypothesize that systematic partisan differences between preferences on all these issues are likely to emerge. Of course, the strength of the partisan effect will depend very heavily on the distinctiveness of incumbency,

both in terms of single-party government versus coalition government and of stability of governments. Where voter alignments and party systems become more fluid, long-term single-party or single-block governments become less likely and policy preferences of incumbents will have a lower probability of being converted into policy. Since the late 1960s there has been a general trend towards greater volatility of electorates and the emergence of new small parties (Wolinetz 1990), but this trend has by no means been uniform across countries. The loss of vote share by established political parties from the 1960s to the 1990s has been higher than 25% in Austria, France, Italy, and New Zealand, but 10% or less in Denmark, the United States, Belgium, the Netherlands, and Germany (Kitschelt, forthcoming). In some cases, established parties have been forced into coalitions with rather precarious stability, and the greater need for compromise is most likely to overwhelm partisan preferences and thus a partisan effect on the future development of welfare state regimes in these cases. So, as welfare states are confronted with new challenges under non-crisis conditions, we would hypothesize a resurgence of some partisan differences in policy outcomes, though not as pronounced as during the Golden Age.

ENDNOTES

1. Our efforts here run parallel to those of Ebbinghaus and Manow (1998).
2. The main points of criticism concerned the number and type of regimes, the classification of various countries, and the degree to which countries cluster into the three (or four) distinct groups.
3. Japan does not fit into any type and is being treated as a case apart. The economy is a group coordinated market economy (Soskice 1998) and the welfare state comes closest to a residual model, with very low benefits through the public programs in pensions and health care. The pillars of the system of social provision are private programs in the large corporations, from which only a minority of the labor force benefits, and the family (Pempel 1997).
4. Political differences are not the only factor which distinguishes the groups. Size of the domestic economy, market structure, export orientation, among other factors, have shaped the associated labor market and production regimes which in turn have a feedback effect on the welfare state regimes (e.g. see Stephens 1979, Katzenstein 1985, Hall 1986, Wallerstein 1990). It is beyond this paper to trace these links. We do this in a work in progress (Huber and Stephens n.d.).
5. In the mid-Sixties Finland experienced a "system shift" marked by the coming to power of a social democratic led government including the communists, and by unification of unions and the development of a corporatist social pact with the employers. In the subsequent two and one half decades, Finland caught up with her Nordic neighbors in terms of welfare state generosity (Stephens 1996, Huber and Stephens 1998).
6. Theses figures underestimate the differences between the social democratic and Christian democratic welfare states because they include spending on early pensions and disability pensions which were employed as means of labor force reduction in a number of the Christian democratic welfare states at this time.
7. Austria and Finland were partial exceptions in that the Austrian currency was already pegged informally to the German Mark in the Sixties, and Finnish fiscal and monetary policies tended to be pro-cyclical.
8. The wage dispersion figures are the 90-10 ratio, that is, the wages of a full time employee at the 90th percentile of the wage distribution as a multiple of one at the 10th percentile. The data are from OECD (1996a).
9. For a discussion of Austria's outlier status in this regard, see Pontusson (1996).
10. Italy does have a low wage sector in the black market, and Spain and Portugal have yet larger black and informal sectors.
11. All of the figures in Table 3 are from Luxembourg Income Surveys; calculations by David Bradley.
12. This begs the question of why targeted welfare states (and targeted welfare policies within welfare states) are so ungenerous. The answer generally given in the comparative welfare states literature is that precisely because they are targeted, they have a narrow support base and thus few supporters and many opponents.
13. The data on social assistance programs are from Gough et al. (1997).
14. Agell (1996) claims that micro disincentives were a serious problem in Sweden, while Korpi

(1996) and Dowrick (1996) argue the aggregate growth figures do not sustain the view that the welfare state is a drag on growth. What we are pointing out in the text is that both could be true. In fact, a recent comprehensive review of the empirical literature on the work disincentives of taxes and social benefits reveals that the studies to date yield very contradictory findings (Atkinson et al. 1993).

15 Alber (1998) shows that these reductions, which one might term "real but not apparent" (to the beneficiary, which is why they could be implemented), were quite significant in the case of German pensions. He also points out that cutbacks were often accompanied by new extensions of social programs in Germany and Austria, and to some extent even in the Netherlands.

16 The corresponding figures for liberal welfare states is 64% and for the Antipodes 62%. Among the social democratic welfare states, Finland is the exception as only 43% of men of the 55-64 age group are in the labor force.

17 According to Glyn's figures for all OECD countries, it was actually higher after 1973 (1.2 vs. 1.1% per annum). For the eighteen countries examined here it was slightly lower in the period after 1973.

18 Rowthorn (1995) emphasizes the decline in the rate of profit and the real cost of borrowing. The figures for gross fixed capital formation and savings are for all eighteen countries included in the other tables in this chapter. The figures for real interest rates are only for the nines countries for which OECD (1995: 108) presents data for all three periods. For the most recent period, this table has data for seventeen countries. The additional countries raise the average real interest rate across the countries to 6.2%.

19 Another part of the reason is competition from non-OECD countries for investment funds (Rowthorn 1995).

20 Our calculations, based on OECD (1995:73).

21 It should be pointed out here that the United Sates' unemployment performance in the Eighties, with 7.5% of the labor force unemployed, was hardly outstanding, and liberal welfare states as a group registered higher levels of unemployment than the Christian democratic welfare states, so it is not surprising that the liberal welfare states were not looked to as a model. The U.S. unemployment performance only began to look attractive once the conjunctural features discussed in the following paragraphs kicked in during the Nineties.

22 See Czada (1998) for a discussion of the enormous impact of unification on the German production regime and welfare state.

23 See Huber and Stephens (1998) for a more detailed analysis.

24 Iversen, Pontusson, and Soskice (in press) also argue that Scandinavian bargaining systems converged on the Northern European type but emphasize the movement toward decentralization. This movement is not as dramatic as the one discussed in what follows, as Norway and Finland experience very little change and the interpretation of the changes in Denmark is disputed (compare Iversen 1996 and Wallerstein and Golden 1997), leaving Sweden the only country with undisputed major changes.

25 Iversen's argument would predict that Sweden would be successful because Sweden has moved to a system of coordinated industry level bargaining. According to his argument, those countries with centralized bargaining should have greater difficulty in adapting to such a regime because unions' wage compression goals conflict with other goals, but he admits that this depends on the weight unions place on wage solidarism. The fact that Finnish unions have never had a wage compression policy indicates that the link between centralization and wage compression is not that strong.

26 Only to the extent that the development of monetary arrangements in Europe can be strong-

ly linked to financial internationalization can the present high levels of unemployment be strongly linked to globalization.

27 See Cameron (1998) for an overview of near term possibilities.

28 We do not dispute Iversen's (1998) and Pontusson and Swenson's (1996) contention that a central motivation of Swedish employers in ending centralized bargaining was to end wage compression. Interviews we conducted with economists at both the Swedish employers federation and at LO, the trade union confederation, confirm this.

29 This is not all that surprising if one considers that wage compression was only pursued within the respective trade union confederations, not between them.

30 Unfortunately, the data available for Sweden do not allow us to construct a very clear picture of the trends through time. The OECD data on 90-10 ratios indicate a very small change in wage dispersion from the 2.0 shown in Table 2 for 1981 to 2.1 in 1991. Hibbs and Locking (1996) show a much larger increase in wage dispersion among LO members after the end of centralized bargaining, though wage dispersion in 1990 was still considerably lower than it was when the stage 2 wage compression policy was initiated in the late 1960s. From the LIS data, we can say with some confidence that inequality in disposable household income increased from .20 in 1981 to .22 in 1987 to .23 in 1992, though without decomposing the data, one cannot say what contributed to this outcome. The fact that most of the change had occurred by 1987 indicates that it was probably due to changes in the labor market, including the end of centralized bargaining, and occupational structure, and not to the tax reform, welfare state cuts, and rise in unemployment, all of which came later.

31 Evidence from Denmark and Australia indicates that introducing a funded system (in these cases an earnings related tier) where there was none is likely to produce a fall in private savings that offsets the increased savings which the new funded pension system creates. Arguably, the increased guaranteed income levels in retirement lead people to save less. Our suggestion is to move from currently unfunded systems to partially funded systems, or to move from partially funded systems to more fully funded ones. Since benefits are not being increased, there should not be a decline in savings due to anticipated increases in retirement income.

32 All of the figures are from LIS data and were obtained from the LIS website, http://lissy.ceps.lu/. The calculations were made by Koen Vleminckx.

33 We don't want to indicate that we find the OECD recommendations totally without merit. We agree with some of their suggestions for decreasing labor market rigidity and take up several of their suggestions in the following paragraphs.

34 There is another large assumption behind this argument, namely that Germany can recover from the shock of unification with the production regime preserved in its essentials. In other words, German unification needs to be seen as a temporary shock rather than as a terminal burden on the German production regime and welfare state, with lasting deep recessionary effects on the rest of Europe.

DISCUSSION

Comments by Mauro F. Guillén

In "Welfare State and Production Regimes in the Era of Retrenchment," Evelyne Huber and John Stephens advance three separate arguments. First, the more generous the welfare state in terms of transfer payments, health and pension expenditures, and support for mothers' employment, the lower the income inequality and poverty levels. Second, countries with generous welfare states have generally done at least as well as countries with less generous welfare states in terms of unemployment and economic growth. The third argument establishes an association between welfare state regimes and production regimes. The authors argue that a configuration of mutually consistent and reinforcing generous welfare state programs and coordinated production regimes (corporatism, high union density, low wage dispersion) allow countries to compete in world markets on the basis of high wages and high quality products—the so-called "high road" to international competitiveness. Let me comment on each argument in turn.

I find it difficult to believe that any well-informed academic, policy-maker or journalist would take issue with the first argument. Speaking for myself, I enthusiastically agree with the authors. Welfare states have indeed been effective, and possibly efficient, at improving both the average level and the distribution of socioeconomic well-being among the population. The second argument, by contrast, is not so widely accepted. Believers in the free market argue that no matter how well countries with comprehensive welfare states have performed economically, they could have done even better had they not spent so much on welfare services. As with the first argument, I also take sides with the authors in that it is unclear to me exactly how a less generous welfare state could have helped Sweden or Germany, for instance, enjoy even faster growth and lower unemployment during the bulk of the postwar period. The critics may have somewhat of a point as far as the 1980s and 1990s are concerned. Welfare states in some countries may have imposed high costs on producers. As the authors point out, however, countries with comprehensive welfare states have long been integrated in the global economy and successfully competed in global markets. While I agree with this second argument, it would be germane for the authors to acknowledge that there are limits to the "high road" approach to economic competitiveness. The reason is that Asian countries without comprehensive welfare states—especially Japan—irrupted into global markets during the 1980s with high-quality products of their own, thus challenging the likes of Sweden and Germany.

The third argument invites more extensive criticism. While the authors do not deny the existence of a process of globalization, they think that it does not affect the association between welfare state and labor market regimes. The evidence indicates otherwise. The largest companies in countries such as Sweden, Switzerland and Germany, for example, are still owned and managed by citizens or corporations based in the home country, but have swiftly increased their foreign production in recent decades. These firms have come to employ over half of their workers outside of the home country, and in some cases the proportion is greater than 90%. The increased globalization of business is causing a disjunction between welfare state and production regimes. I suggest that this issue—with all of its ramifications—needs to be addressed explicitly. Who pays for the Swedish welfare state? Citizens and Swedish multinationals like Electrolux

which, in spite of having dispersed their operations geographically, still locate in Sweden most high-value added activities and distribute dividends to their Swedish owners. Who benefits from the Swedish welfare state? Certainly not the 85% of Electrolux workers employed outside of Sweden. Thus, the globalization of business may not affect either the boundaries or the economic viability of the welfare state, but it surely affects the boundaries of production regimes thus calling into question the association between welfare states and production regimes.

Evelyne Huber and John D. Stephens respond

1) "There are limits to 'high road' competitiveness for European countries with generous welfare states, as Asian countries without comprehensive welfare states have broken into high-quality product markets."

Response: This is true, but German firms, for instance, have preserved their share of growing world markets, and export firms in other countries with coordinated economies and generous welfare states have also done very well. We can suggest several reasons for this continued high performance, such as reputation based on long-standing presence in these markets, accumulated experience, continued high R&D expenditures, and high quality service coming with the products. High quality service means that with the turbines for electric power generation, or the precision instruments for manufacturing, etc., come the technical staff that install the products, instruct local personnel, and come back to service the installations. This technical staff typically is highly experienced and also speaks at least English well(they are frequently fluent in other languages as well). Again, this is not to deny that there are limits to "high road" competitiveness somewhere, but it is to argue that these limits have not been reached yet in the case of these countries. It is important to keep in mind that unemployment in these countries is concentrated among the low skilled, among those who would need jobs in labor intensive manufacturing or service activities. Few jobs for them would be available in the high-quality export product sectors, even if these sectors were to grow faster.

2) "Increased globalization is producing a disjunction between welfare state and production regimes, as multinational corporations headquartered in countries like Sweden or Germany have over half, or even over 90% of their employees abroad. Who pays for the Swedish welfare state? Multinational firms still have most high-value added activities in their home countries and pay dividends to domestic owners. Who benefits from the Swedish welfare state? Certainly not the employees outside of Sweden."

Response: Production regimes as a concept denote national systems of incentives and constraints in the production of goods and services. These incentives and constraints certainly change if major actors have half or more of their employees outside the borders of the country. Most prominently, as we acknowledge in the paper, the internationalization of production makes the threat of exit more credible and thus gives capital more leverage vis-a-vis both labor and governments. However, this does not mean that there is a disjunction between production regimes and welfare state regimes, or that the production regime becomes less relevant for the welfare state regime. Rather, the advantages that national production regimes offer to firms in terms of labor qualification and cooperation remain relevant precisely to retain the high value-added activities, and retention of these activities remains crucial for the viability of the welfare state.

As to the more specific questions about who pays for the welfare state, or what the relative contribution of taxes on corporate profits and on dividends distributed to owners is, we can make the following observations: the method of financing welfare states varies considerably from country to country. In general, entitlements based on citizenship tend to be financed from general taxation, and earnings-related benefits tend to be financed by contributions from employees and employers, again with considerable variation of their respective shares. Thus, taxes on corporate profits and on dividends would at most contribute to the part of financing coming from general taxation. However, the share of corporate taxes in total tax revenue is rather low across the OECD, averaging 8% in 1994. Moreover, this share has remained essentially constant over the past three decades, standing at 9% in 1965, and 8% in 1975 and 1985. This leaves us with the role of taxes on dividends from abroad in financing the welfare state. Here we have to accept the possibility that in fact shareholders of corporations headquartered in countries with generous welfare states reap high returns from the foreign operations of these corporations and that thus these foreign operations strengthen the tax base of the countries with generous welfare states. To assess the significance of this, one would want to know what the share of earnings from foreign operations is in the total earnings of these corporations, what the share of dividend income in personal income is, and how dividend income is taxed compared to earnings.

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Table 1
Welfare State Regimes, Circa 1980

	1	2	3	4	5	6	7	8	9	10	11	12
	Left Cabinet years	Christian Democratic Cabinet years	Social Security Expenditure	Transfer Payments	Total Taxes	Public HEW Employment	Health expenditure % public	Health employment % public	Pension expenditure % public	Spending on Non-aged	Decommod-ification index	Support for Mothers Employment
Social Democratic Welfare States												
Sweden	30	0	31	18	56	20	92	92	86	12.7	39	62
Norway	28	1	20	14	53	15	98	88	82	8.5	38	43
Denmark	25	0	26	17	52	18	85	85	71	11.5	38	64
Finland	14	0	17	9	36	9	79	88	69	10.5	29	66
Mean	24.3	0.3	23.6	14.5	49.4	15.5	88.5	88.3	77.0	10.8	36.2	58.8
Christian Democratic Welfare States												
Austria	20	15	21	19	46	4	69	59	68	4.1	31	
Belgium	14	19	21	21	43	6	82	31	60	10.2	32	59
Netherlands	8	22	27	26	53	4	76	16	69	12.6	32	34
Germany	11	16	23	17	45	4	79	34	70	8.0	28	36
France	3	4	25	19	45	7	79	63	68	7.5	28	53
Italy	3	30	20	14	33	5	84	75	72	3.4	24	36
Switzerland	9	10	13	13	33	5	68	47	71		30	
Mean	9.6	16.4	21.6	18.4	42.4	5.0	76.7	46.4	68.3	7.6	29.3	43.6
Liberal Welfare States												
Canada	0	0	13	10	36	4	75	18	58	5.7	22	35
Ireland	3	0	19	13	39		92		55	6.8	23	
UK	16	0	17	12	40	8	90	95	67	9.2	23	22
USA	0	0	12	11	31	5	42	23	61	4.5	14	14
Mean	4.7	0.0	15.2	11.5	36.5	5.7	74.8	45.3	60.3	6.6	20.6	23.7
"Wage Earner" Welfare States												
Australia	7	0	11	8	31	7	62	58	59	2.8	13	22
New Zealand	10	0	16	10	.		84		88	3.1	17	
Japan	0	0	10	10	28	3	71	19	54	2.4	27	

Table 2
Labor Market Regimes, Circa 1980

	1 Female labor force participation	2 Union Density %	3 Union Coverage	4 Corporatism Index	5 Centralization of wage setting†	6 Wage Dispersion†	7 Active labor market policy spending / unemployment
Social Democratic Welfare States							
Sweden	74	82	83	4	60	2.0	75
Norway	62	59	75	4	57	2.0	26
Denmark	71	70		3	60	2.1	20
Finland	70	73	95	3		2.5	18
Mean	69.3	71.1	84.3	3.5	59.0	2.2	35
Christian Democratic Welfare States							
Austria	49	66	71	4	20	3.5	8
Belgium	47	72	90	3	34	2.4	10
Netherlands	35	38	60	4	47	2.5	10
Germany	51	40	76	3	20	2.7	10
France	54	28	92	*	20	3.3	7
Italy	39	51		2	40	2.6	4
Switzerland	54	35		3		2.7	23
Mean	47.0	47.0	77.8	3.2	30.2	2.8	10
Liberal Welfare States							
Canada	57	31	38	1	9	4.0	6
Ireland	36	68		3			9
UK	58	48	47	2	28	2.8	6
USA	60	25	18	1	6	4.8	4
Mean	52.8	43.0	34.3	1.8	14.3	3.9	6
"Wage Earner" Welfare States							
Australia	53	51	80	1	40	2.8	5
New Zealand	45	59	67	1		2.9	20
Japan	54	31	21	*	16	3.0	6

* concertation without labor, † mid-eighties data for Belgium, Netherlands, and New Zealand, 1991 for Switzerland

Table 3
Welfare State Outcome, Circa 1980

	1	2	3	4	5	6
	Post tax transfer Gini	Redistribution resulting from taxes and tranfers	Post tax transfer Gini - Aged	% of group in poverty		
				25-59	Aged	Single Mothers
Social Democratic Welfare States						
Sweden	.20	52	.16	4.8	0.3	7.7
Norway	.22	40	.26	3.7	4.7	12.1
Denmark	.26	36	.24	4.8	9.2	4.5
Finland	.21	38	.22	3.0	3.0	4.8
Mean	.22	41.4	.22	4.1	4.3	7.3
Christian Democratic Welfare States						
Austria	.23		.25	2.3	6.0	13.3
Belgium	.23	46	.23	4.4	6.0	14.2
Netherlands	.28	38	.27	6.7	3.9	6.6
Germany	.25	38	.29	4.2	10.0	6.0
France	.32	35	.31	9.1	16.0	26.8
Italy	.31	28	.30	10.5	8.3	17.5
Switzerland	.32	21	.37	6.1	15.2	22.4
Mean	.28	34.2	.29	6.2	9.3	15.3
Liberal Welfare States						
Canada	.29	24	.31	10.3	9.3	42.0
Ireland	.33	35	.32	10.9	4.9	15.4
UK	.27	33	.26	5.5	4.8	10.8
USA	.31	26	.34	11.9	21.8	42.3
Mean	.30	29.4	.31	9.7	10.2	27.6
"Wage Earner" Welfare States						
Australia	.29	29	.29	9.3	5.3	44.8

Table 4
Unemployment and Growth

	Unemployment					Growth			
	1960-73	1974-79	1980-89	1990-94		1960-73	1973-79	1979-89	1990-93
Social Democratic Welfare States									
Sweden	1.9	1.9	2.4	5.2		3.4	1.5	1.8	-1.6
Norway	1.0	1.8	2.7	5.6		3.5	4.4	2.3	2.0
Denmark	1.4	6.0	8.1	10.9		3.6	1.6	1.8	1.0
Finland	2.0	4.6	5.1	12.3		4.5	1.8	3.2	-3.6
Mean	1.6	3.6	4.6	8.5		3.8	2.3	2.3	-.6
Christian Democratic Welfare States									
Austria	1.7	1.6	3.3	3.9		4.3	3.0	1.9	1.0
Belgium	2.2	5.7	11.3	10.7		4.4	2.1	1.9	1.2
Netherlands	1.3	5.0	9.7	6.2		3.6	1.9	1.1	1.2
Germany	.8	3.4	6.7	7.8		3.7	2.5	1.7	2.1
France	2.0	4.6	9.1	10.6		4.3	2.3	1.6	.2
Italy	5.3	6.3	9.3	10.6		4.6	3.2	2.4	.7
Switzerland	.0	.4	.6	2.7		3.0	-.1	1.8	-.8
Mean	1.9	3.9	7.1	7.5		4.0	2.1	1.8	.8
Liberal Welfare States									
Canada	5.0	7.2	9.3	10.3		3.6	2.9	1.8	-1.0
Ireland	5.2	7.6	14.3	14.9		3.7	3.3	2.7	4.8
UK	1.9	4.2	9.5	8.4		2.6	1.5	2.2	-.3
USA	5.0	7.0	7.6	6.6		2.6	1.4	1.5	.8
Mean	4.3	6.5	10.2	10.1		3.1	2.3	2.1	1.1
"Wage Earner" Welfare States									
Australia	2.0	5.1	7.5	9.6		3.2	1.5	1.8	.3
New Zealand	.2	.8	4.4	9.2		2.2	-.2	1.4	.6
Japan	1.3	1.8	2.4	2.3		8.3	2.5	3.4	2.2
Grand Mean	2.2	4.2	6.9	8.2		3.8	2.1	2.0	.6

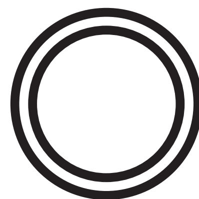
Unemployment figures are percentage of the labor force unemployed.
Growth figures are percentage annual increase in GDP. Source: OECD.

Table 5
Labor Force Participation by Gender

	Female Labor Force, % of Females 15-64						Male Labor Force, % of Males 15-64				
	1960	1973	1980	1990	1994		1960	1973	1980	1990	1994
Sweden	50	65	77	76	76		99	89	86	86	79
Norway	36	50	66	71	71		92	87	87	85	82
Denmark	44	63	74	78	78		100	90	88	90	87
Finland	66	66	73	70	70		91	80	82	81	78
Mean	48.9	60.9	72.3	73.7	73.7		95.4	86.4	85.7	85.2	81.5
Austria	52	53	50	59	59		92	86	82	80	81
Belgium	36	42	49	54	54		86	83	77	73	73
Netherlands	26	30	40	56	56		98	84	77	80	79
Germany	49	51	52	61	61		94	89	83	80	78
France	47	51	54	59	59		95	85	78	75	75
Italy	40	34	40	43	43		95	85	81	79	75
Switzerland	51	54	54	59	58		100	100	94	95	93
Mean	43.0	44.9	48.5	55.7	55.6		94.3	87.4	81.7	80.4	78.8
Canada	34	49	60	65	65		91	87	85	85	78
Ireland	35	34	38	41	41		99	96	92	90	89
UK	46	54	57	65	65		99	92	88	86	84
USA	43	52	62	69	69		91	86	84	85	85
Mean	39.3	47.3	54.2	60.2	60.2		94.9	90.1	87.1	86.6	84.1
Australia	34	49	53	62	62		97	91	87	86	85
New Zealand	31	41	46	63	63		94	89	85	83	83
Japan	60	52	57	62	62		92	90	89	88	90
Grand Mean	43.3	49.4	55.6	61.8	61.8		94.7	88.2	84.6	83.7	81.8

Table 6
Ratios of Active to Dependent Populations

	Working Age Population per Elderly Person			Working Age Population per Dependent Person			Ratio of working population to non-working population		
	1960	1990	2020	1960	1990	2020	1960	1980	1989
Social Democratic Welfare States									
Sweden	5.5	3.6	3.0	1.9	1.8	1.6	.92	1.04	1.11
Norway	5.7	4.0	3.6	1.7	1.8	1.7	.67	.88	.94
Denmark	6.0	4.3	3.3	1.8	2.1	1.8	.81	.95	1.06
Finland	8.5	5.0	2.9	1.7	2.1	1.7	.92	.97	1.01
Mean	6.4	4.2	3.2	1.8	2.0	1.7	.83	.96	1.03
Christian Democratic Welfare States									
Austria	5.4	4.5	3.3	1.9	2.1	2.0	.87	.69	.78
Belgium	5.2	4.5	3.1	1.8	2.0	1.8	.64	.61	.61
Netherlands	6.8	5.4	3.2	1.6	2.2	1.8	.57	.56	.71
Germany	5.8	4.6	3.3	2.1	2.2	2.0	.89	.78	.81
France	5.3	4.7	3.0	1.6	1.9	1.7	.76	.68	.65
Italy	7.0	4.7	2.7	1.9	2.2	1.8	.74	.60	.60
Switzerland	6.2	4.5	3.2	1.8	2.0	1.8	1.00	.98	1.10
Mean	6.0	4.7	3.1	1.8	2.1	1.8	.78	.70	.75
Liberal Welfare States									
Canada	7.7	5.9	3.1	1.4	2.1	1.8	.53	.81	.92
Ireland	5.2	5.4	4.0	1.4	1.6	1.8	.59	.51	.45
UK	5.5	4.2	3.5	1.9	1.8	1.8	.86	.82	.88
USA	6.5	5.3	3.6	1.5	1.9	1.8	.61	.80	.93
Mean	6.2	5.2	3.6	1.6	1.9	1.8	.65	.74	.80
Antipodes									
Australia	7.2	6.0	3.7	1.6	2.0	1.9	.66	.76	.86
New Zealand	9	5.8	4.1	1.4	1.9	1.9	.58	.68	.78
Japan	11.2	5.8		1.8	2.3		.91	.90	.99



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