Journal of European Public Policy
Publication details, including instructions for authors and subscription information:
http://www.tandfonline.com/loi/rjpp20

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Published online: 04 Feb 2011.

To cite this article: (2003) Political parties, institutions, and the dynamics of social expenditure in times of austerity, Journal of European Public Policy, 10:1, 20-45, DOI: 10.1080/1350176032000046912

To link to this article: http://dx.doi.org/10.1080/1350176032000046912

Journal of European Public Policy 10:1 February 2003: 20–45

Political parties, institutions, and the dynamics of social expenditure in times of austerity

Bernhard Kittel and Herbert Obinger

ABSTRACT The containment of social expenditure growth has been a core issue of public policy in advanced industrial countries since the 1980s and has received much academic attention. Among the most extensively discussed explanatory factors of social expenditure are partisan politics and political institutions, as well as the dependency of the real impact of the former on the latter. The paper distinguishes five competing theoretical perspectives and explores their power to explain the empirical variation of social expenditure dynamics during the period 1982–97 in twenty-one OECD countries. By using an interactive model specification, we show that there is empirical evidence for this conditional effect, albeit it is not thoroughly convincing. In total, the evidence first suggests that the effect of politics on social expenditure is rather limited, and, second, tends to support the 'growth-to-limits' and the 'new politics' perspectives more.

KEY WORDS Party politics; political institutions; social expenditure; welfare state retrenchment.

1. INTRODUCTION[1]

The end of the post-war economic miracle in the late 1970s was a watershed for social policy development. Rising unemployment rates, increasing public debt, declining economic growth, internationalization, and changing demographics and occupational structures have increased the pressure on the advanced welfare state over the years and have prompted social policy reform in many countries. Consequently, increasing interest has emerged in issues relating to the marked challenges facing the mature welfare states now that they have left the halcyon days of the golden age behind them (Bonoli *et al.* 2000; Ferrera *et al.* 2000; Scharpf and Schmidt 2000; Huber and Stephens 2001; Kuhnle 2000; Leibfried 2001; Pierson 2001; Schmidt 2001).

This paper focuses on the role of politics as a driving force behind the variation in the dynamics of social expenditure between 1980 and 1997, a period marking the end of the expansionary phase and the shift to austerity. We

Journal of European Public Policy
ISSN 1350-1763 print; 1466-4429 online © 2003 Taylor & Francis Ltd
http://www.tandf.co.uk/journals
DOI: 10.1080/1350176032000046912

examine the impact of democratic politics and constitutional state structures on social expenditure and investigate interaction effects between these variables, while simultaneously controlling for a range of socio-economic determinants of social spending.

The paper is organized as follows: in Section 2, we start with a brief summary of the theoretical arguments on the impact of politics on welfare state dynamics. Section 3 presents an overview of the findings derived from recent quantitative research. Section 4 presents a series of models of the factors determining welfare dynamics during the period from 1980 to 1997. In closing, Section 5 interprets the findings and summarizes our conclusions.

2. POLITICS AND THE WELFARE STATE: THEORETICAL ACCOUNTS

We offer here a brief summary of five main perspectives on the political determinants of social policy discernible in the literature. Specifically, we focus on the effects of the partisan complexion of government and constitutional structures and summarize recent discussions on whether these factors still have explanatory power in the global economy.[2]

First, there is consensus among institutionalists that the ways in which nations react to the common challenges of increased economic vulnerability depend on institutional configurations and policy legacies. But some pessimistic economists expect a *race to the bottom* in welfare provision, which is driven by increased exit options for mobile capital in the wake of deepened economic integration (Sinn 1997). According to this view, the role of politics is subordinated to the market forces, which induce a downward spiral in welfare provision irrespective of ideology. Apparently, the convergence-to-the-bottom hypothesis has no room for politics since unfettered market forces determine a new social expenditure equilibrium at a low level. In a similar vein, Strange (1995: 291) argues that globalization undermines the primacy of politics and that 'the differences that used to distinguish government policies from opposition policies are in process of disappearing.'

Second, more optimistic accounts stress that globalization has not diminished the room to manoeuvre for leftist parties but has even expanded it to a degree (Garrett 1998: 1). According to this view, the entire globalization debate has been much ado about nothing, and the claims that the welfare state is facing a major crisis closely resemble a 'cliché' (Garrett and Mitchell 2001: 145). For example, according to the supply-side logic of economic policies, leftist parties concentrate their efforts in human capital formation and intervene at much higher levels in this area than rightist parties do (Boix 1998). In sum, this body of reasoning concludes that the *old politics* paradigm of the welfare state still has explanatory power. Those constellations and actors inimical and those conducive to welfare statism are thus expected to stimulate welfare state retrenchment and expansion, respectively. Accordingly, a divergence in welfare efforts is more likely to persist since affluent democracies can resist the challenges of globalization, with the result that the existing varieties in welfare capitalism are preserved.

Third, Pierson (1996, 2001) argues that the politics of welfare state retrenchment in times of austerity is very distinct from the political processes underpinning welfare state expansion (see also Bonoli *et al.* 2000: 23–4). Consequently, 'research on the "golden age" of social policy will provide a rather poor guide to understanding the current period' (Pierson 2001: 2). According to this view, a *new logic of politics* is responsible for the remarkable resilience of the welfare state over the last two decades. This rationale is driven by a politics of blame avoidance that has restrained office-oriented politicians from welfare state retrenchment since efforts to scale down the welfare state involve high risks of electoral punishment. Given this new logic, one might argue that partisan effects on social policy should vanish. As a result, a political ratchet-effect exists because blame avoidance makes a race to the bottom in social standards rather unlikely, while globalization imposes constraints on further welfare state expansion. What we can observe are efforts to renegotiate and restructure the welfare state but not to dismantle it (Pierson 2001: 14). In these efforts, countries face distinct pressures resulting from increased international competition because the impact of globalization is mediated by national employment regimes and welfare state systems (Scharpf 2000: 86).[3] Both Scharpf and Pierson expect 'divergent convergence' (Seeleib-Kaiser 2001: 18), meaning that the mature welfare states face similar pressures for social policy adaptation, but that the countries respond differently to these challenges contingent upon their institutional settings. In the long run, however, welfare states become more similar since all nations are anxious to make their welfare systems more competitive, although the ways in which these adjustments are realized differ from country to country.

Fourth, probably the most pragmatic position expects a natural process of saturation, best described as convergence to an upper-limit welfare state equilibrium that is merely driven by *catch-up*, i.e. a growth to limits (Flora 1986). Big spenders are thus likely to face stronger pressure for welfare state consolidation, while welfare state laggards may still have some leeway in which to expand the scope of public welfare. Consequently, the new politics of the welfare state may be the dominant pattern in the former case, while the traditional political mechanisms of credit claiming may prevail in the latter.

Finally, the most recent contribution to this debate argues that parties and institutions are still important, but their effects on social policy are assumed to be crucially distinct compared to those of the golden age. Kitschelt (2001) argues that the success or failure of retrenchment efforts is contingent upon party system configurations and the general framing of such policies. Centre-of-gravity theories cannot fully grasp recent social policy developments. Instead, Kitschelt (2001: 269) argues that party systems configured around strong centre-right parties are likely to resist benefit cuts in an environment of fiscal and economic crisis. Ross (1997, 2000) and Armingeon *et al.* (2001) assume that leftist parties are most willing and most efficient in implementing reforms aimed at adjusting present social security arrangements to manifold challenges in order to make the welfare state viable in the future. It is hypothesized that leftist parties are more credible because such 'emergency reforms' are aimed at securing the survival of the welfare state in the long run rather than at dismantling it. Hence the left enjoys the support of its clientele and – most importantly – the backing of trade unions. In contrast, centre-right parties are likely to be accused by the left that restructuring of the welfare state 'is simply an exercise in liberal ideology and in saving money on the back of the needy' (Armingeon *et al.* 2001: 3).

To sum up, we are confronted with conflicting hypotheses about the impact of parties and institutions on the dynamics of social expenditure in hard times. The race-to-the-bottom hypothesis expects no partisan and institutional effects. Two accounts – the new politics approach and the catch-up hypothesis – suggest that the impact of politics is unclear. Both approaches assume high path dependency caused by institutional legacies, on the one hand, and past spending levels, on the other. The remaining two approaches expect definite effects on the part of political parties and institutions, but they differ in their expectations about the direction of the effect on social expenditure. According to the 'nothing-has-happened' view, which is strongly inclined to the old politics paradigm, leftist parties still have enough leeway to expand the welfare state, while the other strand of reasoning expects leftist parties to be more engaged in retrenchment efforts in order to sustain the core welfare arrangements for the future. Moreover, four accounts assume specific forms of convergence in spending levels and welfare provision. Only the approach inclined to the old politics paradigm of the welfare state suggests that the present variations in social outlay prevail in the long run.

This paper investigates what quantitative research might contribute toward discriminating between these different accounts. We start from the hypothesis that the old politics paradigm still explains social expenditure dynamics over the last two decades because this can be regarded as the 'null' hypothesis. Hence leftist and Christian democratic parties should augment social expenditure, while institutional hurdles should restrain welfare efforts. However, we extend this perspective by assuming that partisan effects are contingent upon the institutional setting. Before presenting the empirical results, we briefly summarize the findings from previous quantitative research.

3. POLITICS AND THE WELFARE STATE: EVIDENCE FROM QUANTITATIVE RESEARCH

Table 1 summarizes total social expenditure in twenty-one democracies between 1980 and 1997. Three lessons can be drawn from this table. First, the average social spending ratio as a percentage of gross domestic product (GDP) increased from 19.2 in 1980 to 23.8 in 1997. Obviously, a race to the bottom in welfare provision did not take place (see also Castles 2001: 201).

Second, Table 1 reveals convergence in welfare spending across nations. The

Table 1 Total social expenditure as a percentage of GDP in twenty-one advanced democracies

	1980	*1990*	*1997*	*Change 1980–97*
Australia	11.67	14.97	19.25	7.58
Austria	23.87	25.13	26.25	2.38
Belgium	25.59	26.72	25.11	−0.48
Canada	13.33	17.79	16.95	3.62
Denmark	29.35	29.01	30.85	1.5
Finland	18.89	25.15	29.49	10.6
France	23.47	26.91	29.64	6.17
Germany	25.38	24.51	27.75	2.37
Greece	11.52	21.99	22.19	10.67
Ireland	17.61	19.38	17.90	0.29
Italy	18.37	24.02	26.85	8.48
Japan	10.48	11.47	14.76	4.28
Netherlands	28.94	29.49	25.86	−3.08
New Zealand	19.15	22.53	20.70	1.55
Norway	18.79	27.16	26.45	7.66
Portugal	11.57	14.31	19.06	7.49
Spain	16.29	19.98	20.88	4.59
Sweden	29.78	32.18	33.67	3.89
Switzerland	16.75	19.34	27.21	10.46
United Kingdom	18.37	19.70	21.93	3.56
USA	13.86	14.73	16.54	2.68
Mean	19.19	22.21	23.77	4.58
Standard deviation	6.16	5.58	5.25	3.81
Standard deviation of log	0.33	0.27	0.23	–
Range	19.30	20.71	18.91	13.75
Coefficient of variation	0.32	0.25	0.22	0.83

Source: OECD (2000a).

shrinking coefficient of variation reported in Table 1 indicates prevalence of σ-convergence, i.e. a convergence in spending levels. However, there is also strong evidence of β-convergence[4] for the period under review. β-convergence occurs if the growth rate of social expenditure is inversely related to the initial spending level. Finally, the data still show a considerable variation in welfare efforts as it is expressed by a range of 18.9 percentage points in 1997. The last column of Table 1, which indicates the change in welfare efforts between 1980 and 1997, shows a considerable variation across nations with respect to the extent to which social spending levels have changed over the last two decades.

To date, numerous quantitative studies have tried to single out the role of political determinants in explaining the variation of social spending levels in advanced Organization for Economic Co-operation and Development (OECD) countries. They have presented findings that – depending, inter alia, on the countries and period analysed, the model specification, and the operationalization of the various relevant variables – support practically all of the aforementioned perspectives. Table 2 summarizes the main findings of sixteen studies published in the last ten years on how politics influences welfare efforts. Many studies focusing on the golden age conclude that the partisan complexion of government is important for understanding cross-national variation in welfare efforts. Most of the studies examined agree that leftist and Christian democratic incumbency is strongly associated with higher spending efforts (Hicks and Swank 1992; Huber *et al.* 1993; Hicks and Misra 1993; Schmidt 1997; Huber and Stephens 2001). Moreover, electoral competition and processes of ideological contagion between these party camps were found to augment social spending (Hicks and Swank 1992). In contrast, Garrett and Mitchell (2001: 168) see no evidence that the partisan complexion of government does influence social spending in the short run, although they insist that 'partisanship is likely to have been an important historical element in the evolution of welfare state regimes'. Kittel *et al.* (2000) find inconsistent, i.e. period-specific, evidence for partisan effects on social spending dynamics. Hicks and Kenworthy (1998), Iversen (2001), and Swank (2001) find only minor evidence for partisan effects on social policy. Hicks and Kenworthy (1998) and Swank (2001) stress the importance of neo-corporatist institutions for redistributive policies and outcomes. Garrett (1998: 82) comes to the conclusion that the interaction of strong labour market institutions with leftist governments ('left-corporatism') and unrestricted capital mobility stimulates spending on income transfers.

Hicks and Swank (1992) provide empirical evidence that voter turnout and partisan competition drive public spending. By contrast, Iversen (2001: 68) and Huber and Stephens (2001: 68) find no evidence that voter turnout affects welfare efforts. Beginning with Wilensky (1975: 53) and Cameron (1978: 1248–9), many scholars have identified fragmented state structures as being inimical to higher spending levels. Huber *et al.* (1993), Schmidt (1997), and Huber and Stephens (2001) report a significantly negative impact of an index of institutional pluralism on welfare efforts. Castles (1999: 47–9) and Swank (2001: 222–3) corroborate these findings by identifying federalism as detrimental to high levels of social spending. Conversely, Hicks and Swank (1992: 666) and Hicks and Misra (1993: 690–5) identify state centralization and bureaucratic traditionalism as factors that buoy social spending.

The bulk of the studies cited focus attention on the golden age of the welfare state. Only a few studies under review concentrate exclusively on recent social policy development. In his analysis, Siegel (2001, 2002) by and large confirms the empirical findings derived for the golden age. Leftist parties and to a lesser extent Christian democratic parties still push up social outlay, while institutional fragmentation and single party governments hamper welfare efforts. In contrast, Huber and Stephens (2001: 220) conclude that partisan effects 'disappeared virtually entirely in the 1980s' and that 'the overall pattern is one of a sharp narrowing of political differences' (Huber and Stephens 2001a: 221). Swank also finds no partisan effects, but concludes that political institutions shape 'social policy responses to domestic fiscal stress and internationalization' (Swank 2001: 232). Wagschal (2000) uncovers no partisan effects but reports that the fractionalization of the party system buoys spending. Castles (2001) can find no evidence in favour of either partisan influences or the effects of corporatism and concludes that political factors 'are still reflected in levels of expenditure, but do not appear to have been nearly so influential in determining the trajectories of spending in recent years' (Castles 2001: 210). Armingeon *et al.* (2001) observe for the period between 1985 and 1998 that leftist parties and consociational democracies have been successful in containing social spending, while institutional constraints have lost their braking impact on social expenditure growth.

4. AN EMPIRICAL ASSESSMENT OF WELFARE STATE DYNAMICS

4.1 Parties and institutions: the conditional hypothesis

In the literature cited above, the linkage between partisan preferences of the government and institutional constraints to policy implementation is usually acknowledged at the theoretical level, but the empirical analysis does not reveal an explicit recognition of this contingency. For example, Swank (2001: 210) notes that 'federalism, bicameralism, and presidentialism constitute potentially important "institutional" veto points that allow conservative interests the opportunity to oppose welfare policy development and slow policy change'. However, not one of the contributions surveyed above brings the two factors together empirically by exploring the dependence of the effect of partisan politics on constitutional constraints. Hence, our contribution to the empirical analysis of the partisan effect is to explicitly take into account this hurdle to policy-making by modelling a conditional effect between party strength in government and institutional constraints.

In a period of austerity, institutional constraints may not only restrict the ability of leftist and Christian democratic parties to enhance welfare spending, but also a government's attempts to contain cost expansion. If the partisan logic continues to hold, parties supportive of encompassing welfare states will be more likely to surrender to opposition against spending cuts formulated at various institutional veto points than parties engaging in a policy of welfare state retrenchment. Hence if this argument is correct, we would expect to observe a strong positive association between leftist and Christian democratic government strength respectively and changes in welfare expenditure if few institutional constraints hinder these parties from implementing their preferences. In contrast, no effect should be visible if opposing actors have more opportunities to block government policies.

Table 2 The existing evidence: studies on social expenditure

Author(s)	*N*	*Period (design)*	*Dependent variable*	*Impact of politics*
Hicks and Swank (1992)	18	1960–82 (pool)	Social expenditure/GDP	Leftist parties (+), centre parties (+), electoral turnout (+), bureaucratic traditionalism (+), state centralization (+) and left corporatism (+)
Hicks and Misra (1993)	18	1960–82 (pool)	Social expenditure/GDP	Leftist parties (+), centre parties (+), bureaucratic paternalism (+), strikes (+), voter turnout (+), left corporatism (+), state centralization (+), electoral competition (−)
Huber *et al.* (1993)		1960–89 (pool)	Social expenditure/GDP	Leftist parties (+), Christian democratic parties (+), institutional veto points (−)
Schmidt (1997)	18	1960–92 (pool)	Social expenditure/GDP	Leftist parties (+), Christian democratic parties (+), liberal parties (+), age of democracy (+), conservative parties (−), institutional veto points (−), single party government (−)
Garrett (1998)	14	1966–90 (pool)	Income transfers	Interaction of leftist parties and powerful labour market institutions (+), high exposure to trade (+)
Hicks and Kenworthy (1998)	18	1960–89 (pool)	Government transfers, decommodification, active labour market policy (ALMP)	Transfers, decommodification: neo-corporatism (+) Active labour market policy: left (+) Social transfer payments: Christian democracy (+)
Castles (1999)	16/17	1960–93 (cross-section)	Change in total social expenditure/GDP	Decentralization (−)
Kittel *et al.* (2000)	18	1960–95 (pool, cross-section)	Social expenditure/GDP	Institutional veto points (−) [1960–89], no consistent partisan effects
Wagschal (2000)	21	1980–95 (cross-section)	Change in social expenditure/GDP	No partisan effects, fractionalization of party system (+)

Table 2 Continued

Author(s)	*N*	*Period (design)*	*Dependent variable*	*Impact of politics*
Siegel (2001)	22	1980–95 (pool)	Social expenditure/GDP	Leftist parties (+), single party government (−), veto points (Schmidt index) (−), single party government (−)
Swank (2001)	15	1965–95, 1979–95 (pool)	Social expenditure/GDP	Social corporatism (+), inclusive electoral institutions (+), federalism (−), no partisan effects
Garrett and Mitchell (2001)	18	1961–91 (pool)	Social security transfers/ GDP	No effect of different partisan portfolios when lagged dependent variable and a battery of country and time dummies are included
Castles (2001)	19	1984–97 (cross-section)	Change in social expenditure/GDP	No partisan effects
Iversen (2001)	15	1961–93 (pool)	Total government spending, government transfers and government consumption as % of GDP, unemployment replacement rate	Replacement rate, government consumption: leftist parties (+) Government consumption: voter turnout (+) Government consumption: concentration of union power (+)
Armingeon *et al.* (2001)	22	1960–98 (repeated cross-section)	Social expenditure/GDP	Golden age (1960–84): corporatism (+), consociational democracy (+), leftist and centre parties (+/−), veto points (−) 1985–98: leftist parties (−), consociational democracy (−), no effect of institutional constraints, centre parties (+/−)
Huber and Stephens (2001a)	18	1958/61–1989/ 95 (pool, cross-section)	Social security benefits/ GDP	Golden age (until 1985): leftist parties (+) and Christian democratic parties (+), institutional veto points (−) 1980s, early 1990s: no partisan effects

(+) = positive association; (−) = negative association

4.2 Approach, variables, and data

As Section 3 has shown, most quantitative research of the determinants of social expenditure has focused on its levels, instead of its dynamics. Indeed, many decisions in the field of social policy have little immediate effects but 'mature' over time, which implies that the generosity of welfare systems is the result of small but cumulating differences in provision. According to many authors, this warrants an analysis of levels of social expenditure (e.g. Garrett and Mitchell 2001; Huber and Stephens 2001; Swank 2001). However, we contend that this strategy is less suitable for exploring political efforts to contain or even retrench the growth of social expenditure. Substantively, the analysis of annual changes (first differences) has much more to offer than has been asserted in the literature hitherto. One of the least disputed propositions of the path-dependency literature is that, once social programmes are in place, policy-makers can only make marginal changes to them at best. Since the welfare systems were all basically established by the end of the 1970s, we should expect the starting level to capture most of the variation in the end level for the period analysed here. This is confirmed by a cross-sectional regression of the level of social expenditure in 1997 (expressed as a percentage of GDP) on the level of social expenditure in 1980, yielding (standard errors in parentheses):

$$\text{Social expenditure (1997)} = \underset{(2.39)}{10.73} + \underset{(0.12)}{0.68} \times \text{social expenditure (1980)} \qquad R^2 = 0.63, N = 21.$$

If we wish to know whether policy reorientations in the 1980s and 1990s were consequential in terms of social expenditure, this finding implies that there is little to learn from an analysis of the levels in a panel model. If party preferences or institutions make any difference, we should find systematic variation in average growth, expressed in percentage point changes, for example. Although effects of policy changes in the large areas of social expenditure – old age pensions and health care – often materialize only after many years, there are policy areas where governments wishing to embark on a policy of welfare retrenchment can attain more immediate success – e.g. benefits for the long-term unemployed, family allowances, or the financial endowment of the social infrastructure. Hence, we should find repercussions of policy choices and institutional constraints on short-term dynamics in aggregate social expenditure owing to such policy choices, although these will certainly not be the only ones. This suggests the necessity to estimate a pooled model of the percentage point changes in social expenditure.

Yet, this strategy leaves two important caveats:[5] first, such a model assumes that the world in the 1990s was basically identical to the world in the 1980s. But the collapse of the Council for Mutual Economic Assistance (Comecon) regimes, German unification, the Maastricht Treaty, along with the ongoing internationalization of the capital market, employment crises, and soaring expenditures on health and pensions, have contributed to considerable changes in government perspectives on social expenditure. If these changes had any empirical relevance, they will be reflected in parameter instability over time. Therefore, in a second step we re-estimate the pooled model for two sub-periods and compare the coefficient estimates. Second, the annual changes capture only short-term effects, which implies that the 'real' impact may be considerably underestimated (Huber and Stephens 2001: 36). Thus our third step is to explore the longer-term effects in a cross-sectional model of the change over the entire period covered in the preceding analysis.

Our dependent variable is the annual percentage point change in total social expenditure as a percentage of GDP. The political variables of special interest are the partisan complexion of government and institutional constraints. Data on cabinet portfolios are drawn from a new data set compiled by Schmidt *et al.* (2000). We follow the traditional approach of including both the leftist (social democratic, socialist, communist and environmentalist) and Christian democratic share of party seats in government (expressed in ratios). A further dimension of party politics is the fractionalization of the party system. Since fractionalized party systems typically reflect societal cleavages, social policy might be a tool to cope with conflicts and to increase the legitimacy of a political system in fragmented societies. This might contribute to an increase in social spending. As a measure of fractionalization we use the index developed by Rae, which is defined as 1 minus the sum of the squared vote shares of all parties (Armingeon *et al.* 2000).

With regard to the institutional structure of the state providing opportunities for opposing groups to constrain government policy, the best-known indices are the Huber *et al.* (1993) index of constitutional structure and the Schmidt (1996) index of institutional constraints on central government. Unfortunately, they contain elements that are either not part of the theoretical considerations of the determinants of social expenditure or are expected to have an ambivalent effect because both positive and negative correlations are plausible. This caveat amounts in particular to the impact of presidentialism versus parliamentarism, the electoral system, and the independence of the central bank. Therefore, we use these two indices as points of reference for our more focused index of institutional rigidity, which is based on Lijphart's (1999) indices of federalism and bicameralism. These two dimensions are considered to be the core constitutional sources of veto power against governments wishing to change the status quo (Tsebelis 2000), and we have combined them into a synthetic index.[6]

We control for the effects of economic and socio-economic variables that are expected to be the driving forces of welfare state reform according to convergence theory. We take into account two aspects of this perspective. First, internal causes of social expenditure growth are considered. These are the rate of economic growth, the size of the ageing population, and the annual changes in unemployment, for all of which we expect positive signs. Second, we include external trade dependence and a dummy for the countries that have signed the Maastricht Treaty with its convergence criteria for European monetary union (EMU), thereby reflecting external pressure to curb social expenditure.

According to the catch-up hypothesis, higher levels of social expenditure should have a diminishing impact on its growth. We also include lagged differences of social expenditure in order to take into account the presumed stickiness of growth. If policy-makers can only change the margins of programmes, it is likely that current growth will be similar to the previous year's growth.

We further control for the funding structure of welfare states, which is meant to capture an important framework dimension of social expenditure growth, isolating the 'conservative', insurance-based welfare regimes from all others. Tax-based social payments are easier targets of government discretion than contributory funded insurance systems, which are based on long-term contracts. This variable is defined as the ratio of social security contributions to total tax revenue.[7] Details concerning the variables and sources of data are summarized in the appendix.[8]

We include time dummies in order to eliminate joint trends and shocks. Hence we transform the model from one described in absolute values into one of relative deviations from the cross-sectional mean of each year, and focus on the cross-sectional dimension (cf. Baltagi 2001: 11–27). The time dummies are highly significant as a group, but we do not report their coefficients in the tables because their values are irrelevant to our argument. Since one of our core variables is institutional rigidity, which is time-invariant, we do not include country dummies.[9] Finally, because the model contains two interactive terms, we enter all explanatory variables in deviations from the overall mean in order to obtain easily interpretable coefficient estimates and to minimize multicollinearity.[10]

4.3 Empirical findings

4.3.1 Panel analysis 1982–97

Table 3 presents different variants of this specification. Equation 1 gives a reference specification that excludes the interaction effects. Equation 2 is the full model as described above. We will discuss it more extensively below. Equations 3 and 4 demonstrate the impact of excluding the controls on the partisan and institutional effects and vice versa. The party and institutional variables account for 1.3 percentage points of explained variation, which are, as Equation 1 shows, primarily attributable to the main effects. However, the five variables jointly do not significantly add to the explained variation ($F = 1.29$, $p = 0.27$). Equation 2 in Table 3 corroborates some of the expectations we have discussed in Section 2, but also shows that the evidence does not support other expectations. The small and insignificant coefficient on lagged growth in social expenditure suggests that there is no evidence of stickiness in expenditure growth. An increase in lagged levels of social expenditure has a negative impact on expenditure growth, thereby confirming the saturation effect. Both unemployment growth and the percentage of the elderly in the population have a stimulating effect on social expenditure. Also, party fractionalization pushes expenditure growth. We further find an expenditure-restraining effect of the sheltering of the welfare state from government discretion in insurance-based systems. In addition, we find a significant negative effect of trade dependence on expenditure growth.

Now let us explore the interaction between parties and institutions. The coefficient estimates and standard errors reported in Equation 2 refer to the main effects, if the other variables are set to their overall mean. Institutional rigidity tends to restrain expenditure growth, while an increase of both leftist and Christian democratic government participation tends to push expenditure growth. The interaction term is negative, as expected. Despite the lack of statistical significance, it is worth exploring the behaviour of the coefficients for different constellations of the variables. Since our conception of institutional rigidity reflects the constitutional framework of policy-making, we analyse the effect of the two government complexion variables at the extreme values of institutional rigidity. The first two columns in Table 4 present the findings. If institutional rigidity is at its minimum, an increase in government participation of both leftist and Christian democratic parties has an accelerating effect on social expenditure growth. For leftist parties, this effect is nullified if institutional rigidity is high, while Christian democratic parties still seem to be able to increase social spending somewhat in this situation. Hence the model suggests that the institutional context notably conditions the ability of leftist parties to increase social expenditure, while the overall higher upward pressure of Christian democratic parties can only be restrained, but not nullified, by institutional constraints.[11]

4.4 Temporal stability, 1982–89 and 1990–97

The models specific to the sub-periods in Equations 5 and 6 of Table 3 reveal that some findings are stable over time, while others change. No noteworthy changes are visible for the effect of the level of social expenditure, GDP growth, growth in unemployment, and trade dependence. The clear effect of the size of the ageing population is reduced in the 1990s. Welfare system differences captured by the ratio of social insurance payments to taxes are pronounced in the 1980s but significantly decline in the 1990s. The effect of party system fractionalization, by contrast, is much stronger in the 1990s. Finally, the most remarkable finding is that the effects of parties and institutional constraints break down in the 1990s. The impact of institutional rigidity as a main effect, which is clearly significant in the 1980s, is practically irrelevant in the 1990s. While the expenditure-boosting effect of Christian democratic parties was both sizeable and statistically significant in the 1980s, it is considerably smaller and insignificant in the 1990s, and the interaction term for these parties changes sign. Only the effect of leftist parties remains constant, although being rather small and, as in the 1980s, insignificant.

Table 3 Determinants of growth in social expenditure: leftist and Christian democratic party effects

	Δ *Social expenditure as % GDP*					
	1 *1982–97*	*2* *1982–97*	*3* *1982–97*	*4* *1982–97*	*5* *1982–89*	*6* *1990–97*
Δ Social expenditure$_{t-1}$	0.05	0.05	0.06	0.16	−0.10	0.26*
	(0.11)	(0.11)	(0.11)	(0.10)	(0.20)	(0.16)
Social expenditure$_{t-1}$	−0.06***	−0.06***	−0.05***	−0.03***	−0.06***	−0.06***
	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)
GDP growth$_{t-1}$	0.03	0.03	0.03		0.07	0.03
	(0.03)	(0.03)	(0.03)		(0.06)	(0.04)
Δ Unemployment	0.35***	0.35***	0.37***		0.32***	0.30***
	(0.07)	(0.07)	(0.07)		(0.10)	(0.09)
Old age$_{t-1}$	0.12***	0.12***	0.12***		0.14**	0.08
	(0.04)	(0.04)	(0.03)		(0.06)	(0.06)
Trade dependence$_{t-1}$	−0.36**	−0.37**	−0.14		−0.35	−0.36
	(0.16)	(0.17)	(0.15)		(0.26)	(0.24)
Maastricht	−0.28	−0.26	−0.22			−0.20
	(0.27)	(0.27)	(0.26)			(0.25)
Social insurance as % of taxes$_{t-1}$	−0.62*	−0.69*	−0.40		−0.91**	−0.36
	(0.33)	(0.33)	(0.25)		(0.39)	(0.67)
Fractionalization$_{t-1}$	1.23***	1.37***	1.10**		0.92*	1.99**
	(0.48)	(0.50)	(0.50)		(0.53)	(0.94)
Institutional rigidity	−0.16	−0.17*		−0.09	−0.22**	−0.12
	(0.09)	(0.09)		(0.08)	(0.10)	(0.16)
Leftist government$_{t-1}$	0.17	0.15		0.26*	0.20	0.21
	(0.14)	(0.14)		(0.13)	(0.18)	(0.20)

Table 3 Continued

	Δ *Social expenditure as % GDP*					
	1	*2*	*3*	*4*	*5*	*6*
	1982–97	*1982–97*	*1982–97*	*1982–97*	*1982–89*	*1990–97*
Institutional rigidity × leftist government$_{t-1}$		−0.17		−0.20	−0.24	−0.23
		(0.17)		(0.16)	(0.21)	(0.32)
Christian democratic government$_{t-1}$	0.60**	0.67**		0.20	0.99*	0.22
	(0.26)	(0.31)		(0.30)	(0.51)	(0.39)
Institutional rigidity × Christian democratic government$_{t-1}$		−0.25		0.23	−0.49	0.24
		(0.34)		(0.34)	(0.49)	(0.53)
R^2 (in %)	38.29	38.46	37.16	28.43	25.38	52.87
Nobs	336	336	336	336	168	168
F (parties & institutions)	1.88	1.29	—	1.24	1.25	0.52

Panel-corrected standard errors in parentheses; Full set of – jointly highly significant – time effects included; F (parties & institutions) = F statistic of joint test for institutional rigidity, leftist government, Christian democratic government and the two interaction terms; ***significant at 0.01 level; **significant at 0.05 level; *significant at 0.10 level.

Table 4 Effects on changes in social expenditure: interaction analysis of institutional rigidity and government complexion

	Institutional rigidity					
	1982–97		*1982–89*		*1990–97*	
	low	*high*	*low*	*high*	*low*	*high*
Leftist parties	0.29	−0.02	0.40	−0.04	0.40	−0.02
	(0.22)	(0.18)	(0.30)	(0.18)	(0.31)	(0.40)
Christian democratic parties	0.88*	0.41	1.39	0.50	0.02	0.47
	(0.52)	(0.30)	(0.82)	(0.44)	(0.73)	(0.44)

Entries are coefficient estimates of the effect on social expenditure growth and panel corrected standard errors for the lowest and the highest value of institutional rigidity. The estimates are based on the models presented in Table 3, Columns 2, 5 and 6.
*significant at 0.10 level.

Hence, the findings tend to support the proposition of a general convergence of social expenditure growth across countries in the 1990s, suggesting that the partisan composition of government had less of an impact on expenditure during that decade. Only one political effect seems to remain, that of party fractionalization. This result suggests that, controlling for the socio-economic push factors, cost-cutting in the welfare state is paramount except in situations where governments must accommodate differing interests arising from the larger number of parties needed to keep a government in office. Therefore, in the 1990s, the ability of governments to embark on a cost-cutting strategy seemed to be more restricted by the need to find compromises among parties, which tend to limit the extent of welfare state retrenchment, than by institutional constraints.

Columns 3–6 in Table 4 and Figure 1 show where the conditional effects break down. For leftist parties, the standard error increases considerably for high institutional rigidity, indicating that some of the countries characterized by this combination were better able to adapt to the constraints of the 1990s. Yet the most interesting finding is the breakdown of the strong expenditure-pushing effect of Christian democratic parties in the case of low institutional rigidity; while in the 1980s the estimated coefficient was 1.36, it collapses to 0.02 in the 1990s. This suggests that Christian democratic parties in particular have responded to the changing economic environment of the 1990s and that they have only been able to do so when they were not inhibited by strong institutional constraints.

As far as the short-run effects are concerned, the evidence for the hypothesized conditional effect is mixed. With regard to the model diagnostics, the improvement in fit is marginal and the conditional effects only partly attain statistical significance. However, given the restricted number of cases and the crudeness of the measures, we interpret the fact that the coefficients behave as

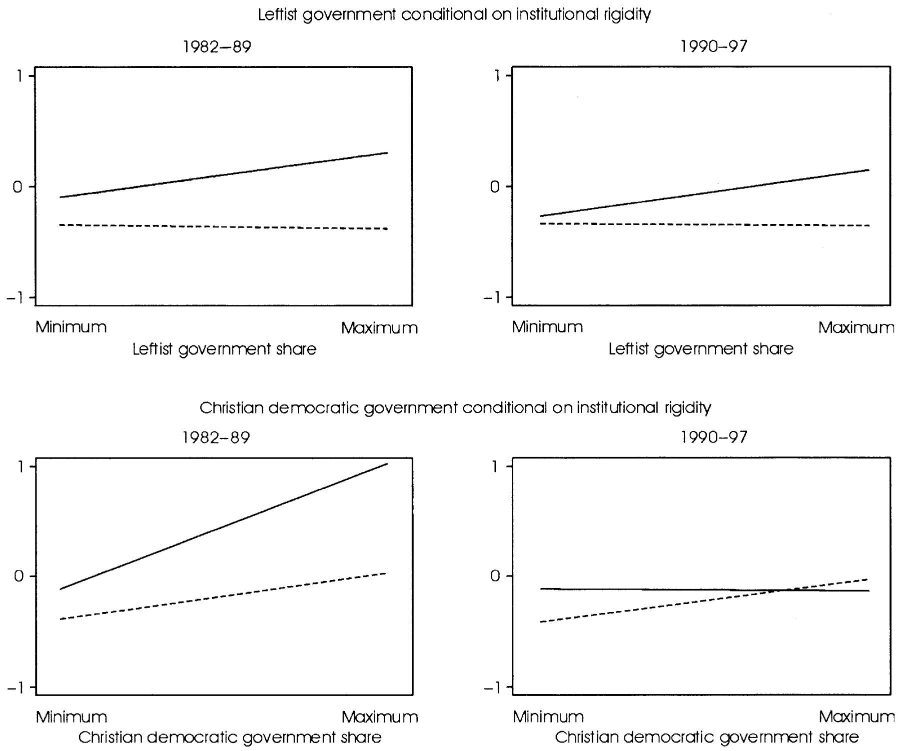

Figure 1 Partisan effects on social expenditure growth conditional on institutional rigidity: comparison of the 1980s and 1990s
Note: Vertical axis: 'Expected values' of social expenditure growth (in percentage points), expressed in deviations from the period mean.

predicted as encouraging evidence. Moreover, the exploration of two sub-periods has yielded the result that political effects are highly unstable and time-bound, the 1990s witnessing a shift in impact on aggregate social expenditure from the simple politics of class to the need to accommodate the variety of preferences expressed in politically fragmented chambers.

4.5 Cross-sectional analysis

We explore the long-term effects by regressing the average of the annual growth rates of social expenditure on the averages of the explanatory factors in Table 5. Equation 1 shows that the saturation effect captures about 50 per cent of the variance in average growth, and Equation 2 shows that socio-economic driving forces account for another 20 per cent. Equation 3 reveals that trade dependence tends to diminish growth but is not statistically significant.

Equations 4–8 add different combinations of the political-institutional

Table 5 Determinants of the growth of social expenditure (1980–97 averages)

	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*
Social expenditure level 1980	−0.14***	−0.19***	−0.19***	−0.19***	−0.19***	−0.18***	−0.20***	−0.19***
	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)
Old age as % of population		0.28**	0.27**	0.20*	0.20*		0.19*	0.21*
		(0.10)	(0.10)	(0.10)	(0.11)		(0.10)	(0.11)
Unemployment growth in %		0.06*	0.06*	0.05	0.05		0.04	0.05
		(0.03)	(0.03)	(0.03)	(0.30)		(0.30)	(0.30)
Trade dependence			−0.40	−0.77	−0.81		−0.99*	−0.79
			(0.51)	(0.52)	(0.54)		(0.50)	(0.54)
Institutional rigidity				−0.38	−0.37	−0.35	−0.38	−0.36
				(0.24)	(0.25)	(0.29)	(0.23)	(0.25)
Welfare government				0.87	0.78	1.44*	0.93	0.92
				(0.62)	(0.67)	(0.76)	(0.59)	(0.65)
Institutional rigidity × welfare					0.42	0.01		
government					(0.87)	(1.09)		
Fractionalization							0.03	
							(0.03)	
Social insurance as % of taxes								−0.55
								(1.28)
Adj. R^2	0.49	0.71	0.71	0.74	0.72	0.54	0.77	0.72
F (Pol. Var.)				1.88	1.26	1.65	2.40	1.24
				[0.19]	[0.33]	[0.22]	[0.11]	[0.34]
N	21	21	21	21	21	21	21	21

Cross-section OLS regression, standard errors in parentheses, constant included but not reported.
All variables defined as averages 1980–97.
Welfare government = sum of leftist and Christian democratic party shares of government seats.
F (Pol. Var.) = Joint F test of all political and institutional variables with p-value in square brackets.
***significant at 0.01 level; **significant at 0.05 level; *significant at 0.10 level.

model. In order to save degrees of freedom, we aggregate the party variables into a combined index of welfare state-supportive parties in government by taking the sum of leftist and Christian democratic parties. None of the extensions to the pure socio-economic model attains statistical significance, but the signs of the coefficients are as expected. In Equation 5, which conditions the effect of welfare-supportive parties on institutional rigidity, the coefficient of welfare parties is b = 0.41 (standard error = 0.66) if institutional rigidity is high, and b = 1.08 (standard error = 0.74) if institutional rigidity is low. Hence the expected conditional effect is present but fails to attain statistical significance. Equation 6 reveals that the conditional effect breaks down and the coefficient of welfare government attains statistical significance as soon as the socio-economic determinants of social expenditure are excluded. Since the latter are important determinants, however, we interpret these results as being indicative of omitted variable bias.

The saturation effect and the socio-economic driving forces are unaffected by the inclusion of the political variables, indicating that the socio-economic model is extremely robust. The effect of trade dependence, in contrast, becomes more pronounced as soon as the model controls for the political variables. Both the coefficients of institutional rigidity and welfare government are fairly robust and suggest that a full-range shift in institutional rigidity amounts to about a 0.7 percentage point decrease in annual growth of social expenditure and that a full-range shift in welfare-supportive government amounts to about a 0.9 percentage point increase in annual growth of social expenditure.

5. CONCLUSION

Starting from theoretical accounts of political influences on social policy, this paper has examined whether the partisan character of national executives impacts on social expenditure dynamics. Empirical results derived from pooled, time-series cross-sectional analysis and from a cross-section of twenty-one affluent democracies suggest that, first and foremost, social expenditure dynamics have been driven by catch-up and by rising dependency ratios as reflected in rising unemployment and population ageing. The corresponding coefficients are robust and temporally stable. Political variables, in contrast, contribute little to explaining welfare state dynamics over the last two decades. We find mixed evidence for the impact of leftist and Christian democratic parties on social spending. While these parties were able to augment social spending in the 1980s, especially when they faced no institutional rigidity, partisan effects disappeared in the 1990s. This temporal parameter shift has been overlooked in previous studies based on pooled time-series cross-section analysis. The only political variable of relevance in the 1990s is the fractionalization of the party system.

As a result, the story recounted by our evidence is as follows: during the 1980s, parties were still able to pursue their preferred policy aims, although they were handicapped if constitutional constraints on government action were in place. The 1990s, by contrast, witnessed a policy reorientation towards budget consolidation, which did not leave social expenditure growth unaffected. This reorientation occurred regardless of the ideological orientation of the governing parties. However, the stable and increasing effect of party fractionalization suggests that consolidation was much more difficult if the incumbent parties needed to find a compromise between different ideological orientations. This can be interpreted as indicative of the impact of logrolling processes. In sum, however, political variables explain a small percentage of the variance in social spending.

An evaluation of the five different accounts on which the debate on the role of politics in hard times is based provides some evidence that the old politics paradigm is still at work. The partisan and institutional effects reported for the 1980s support this argument. Yet spending dynamics in the 1990s is at odds with this view. The catch-up thesis does a better job. Apparently, OECD welfare states converge to a national equilibrium. To put it another way, a major trend which has characterized welfare state dynamics over the last two decades is a growth to limits (Flora 1986). The national steady states of social expenditure seem to be fairly stable since no large-scale roll-back of the welfare state took place over the period under review. However, we want to emphasize that this evidence, derived from aggregate spending data, does not imply that no retrenchment has taken place in recent years in more marginal social policy areas. Nevertheless, the race-to-the-bottom thesis can be rejected. Although we find a negative coefficient on trade dependence in the TSCS model, which is stable over time and quite robust against specification changes, simple inspection of trends in social expenditure reveals that only two countries have reduced their welfare efforts.

Despite support for the old politics hypothesis in the 1980s, a case can be made in favour of the remaining two lines of reasoning which claim the existence of a new politics, on the one hand, and reversed partisan effects, on the other. Both the decline in party orientation effects in the 1990s and the evidence in favour of institutional effects coincide with the expectations advanced by the respective proponents. Although we did not find a negative impact of leftist parties on social expenditure growth, the disappearance of partisan effects and of constitutional constraints in the 1990s supports the hypothesis of a reversed role of political parties. Conversely, vanishing partisan effects may be attributed to a new logic of politics, thereby lending evidence to Pierson's approach. However, the clear and robust effect of the fractionalization of the party system conflicts with the hypothesis put forward by Armingeon *et al.* (2001), who claim that consociational democracies are more prone to retrenchment. Finally, there is also evidence supporting the divergent convergence scenario, which emphasizes the importance of institutional legacies. The structure of the welfare state, insofar as it is captured by the percentage of social insurance contributions in total taxes, plays a role in that countries with large percentages tend to have smaller growth rates of social expenditure. This is counter-intuitive if we take into account the proposition that governments which have a firm grip on the welfare state via its funding by general taxes should be in a better position to embark on retrenchment policies. The evidence, however, suggests that insurance-based systems are better able to contain expenditure growth, in order to cut costs.[12] Alternatively, this might also reflect a saturation effect.

Hence, except for the race-to-the-bottom hypothesis, none of the contentions can be clearly rejected. However, the evidence tends to suggest that social policy has undergone important reorientations in the 1990s which the old politics hypothesis did not predict. Instead, the new politics approach provides some analytic tools which at least do not bluntly contradict the empirical evidence available. Party politics seems to be in retreat, albeit in a way which is different from the way it has been conceptualized in previous accounts. The general and all-embracing theories of partisan effects of the 1980s are to be replaced by a focus on the ways in which the partisan complexion matters in finding functional equivalents for attaining the common goal of welfare state 'recalibration' (Ferrera *et al.* 2000). The breakdown of statistical associations in the 1990s does not mean that politics does not matter anymore. It means that politics matters in more subtle ways. Past legacies, which are the result of earlier government decisions based on party preferences, are a crucial element in understanding the possibilities of adjustment which current governments attempt to initiate.

However, the partisan effects of current decisions are less amenable to quantitative analysis because they have little impact on the aggregate level of social expenditure. More important are qualitative differences and preferred programme foci, which either tend to turn up at the disaggregated level or have little impact in terms of expenditure levels at all. This is the point at which the merits of case studies become obvious.

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NOTES

1 This article is a revised and condensed version of the Max Planck Institute for the Study of Societies Discussion Paper 02/1 (http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp02-1.pdf). The research on which this article is based was conducted while Bernhard Kittel was a researcher at the Max Planck Institute for the Study of Societies, Cologne. We thank Frank Castles, Martin Schludi, Manfred G. Schmidt, Nico Siegel, Christian Toft, Hannes Winner and Patrick Ziltener as well as the anonymous referees for their helpful comments.

2 This implies a restriction of the scope of this contribution, namely the omission of the impact of co-ordinated versus deregulated production regimes, in particular

the role of tripartite arrangements, on dynamics in social spending (see, e.g., Ebbinghaus and Manow 2001; Huber and Stephens 2001b; Swank 2001). However, following this thread would distract too much from the parties/institutions linkage on which we focus here.

3 Yet no consensus exists on how economic vulnerability and trade openness impact on the size of the welfare state; see Rieger and Leibfried (2001).

4 These concepts of convergence stem from growth economists (Barro and Sala-i-Martin 1995).

5 See our MPIfG discussion paper 02/1 (mentioned in note 1) for more extensive robustness tests and an exploration of alternative specifications of the model.

6 We have z-transformed each of the two indices, then added up the resulting scores and divided them by their maximum, yielding an approximate $[-1, 1]$ scale, which allows easy substantive interpretation of the coefficient estimates. See Ganghof (2002) for an extensive and thoughtful critique of the empirical approaches to analyses of institutional constraints to policy-making, including ours. However, doing justice to his points amounts to a case-by-case assessment of the fate of government decisions, which must be left for future research. Sensitivity analyses have revealed that our findings differ little from the results that we would have obtained if we had replaced our measure by the indices proposed by Huber *et al.* (1993) or Schmidt (1996). An interesting approach focusing on the congruence between first and second chambers in parliament has recently been proposed by Cusack and Fuchs (2002).

7 Since reliance on social insurance is typical of conservative welfare regimes in which Christian democratic parties tend to be stronger, one might expect collinearity between the social insurance share and the Christian democratic government share. However, the (pooled) correlation coefficient is only 0.38, leaving sufficient leeway for estimation. In addition, an exploration of the consequences of excluding the social insurance variable from the model does not lead to different conclusions on the effect of other variables.

8 Annual data on social expenditure are missing for Austria (1980–89) and Norway (1980–87). The International Labour Office (ILO) Cost of Social Security 1949–93 data for these countries diverge somewhat from the OECD data for the years available in the OECD database, but tend to converge more with the latter by the late 1980s. Hence we have decided to use the ILO data for these periods in the two countries. We have also re-analysed the models while simply excluding the missing observations. This leads to practically identical conclusions, attaining even 'better' significance levels. Thus the models we present are less permissive.

9 Garrett and Mitchell (2001: 163) emphasize that country effects should be included in order to capture idiosyncrasies and that any time-constant variable should be regarded as being part of the 'underlying historic fabric of a country'. Since political scientists are interested in the extent to which institutional variables capture cross-sectional variation, we regard this as ill-advised.

10 All TSCS analyses were performed with STATA 7 using the xtpcse procedure, which reports OLS coefficients with Beck and Katz's (1995) panel-corrected standard errors. Interaction analyses were programmed in STATA by the authors.

11 We have also explored the responsiveness of the coefficients to the exclusion of each of the countries in turn. Although some of the coefficient estimates vary greatly, all keep the initial sign. In the case of Christian democratic governments, the coefficient estimate appears to be strongly affected by Germany because its removal causes the effect to collapse.

12 We cannot yet provide an unambiguous explanation for this finding. One position could be that this apparent political inaction might be interpreted as a hint that the new politics approach does indeed have much to recommend it. If the organization of welfare programmes is delegated to external institutions such as

social insurance funds, financial problems are likely to be visible at a fairly early stage because demands for additional funding from the government budget must be made publicly. Hence cost pressures might be more likely to be tackled in a technical and problem-oriented way. In contrast, if social expenditures are hidden in the government budget, vested interests may have much more leeway to block reform because they can more easily embark on policies of blame avoidance. However, this conflicts with the argument that tax-financed systems are easier to change because they are more open to government discretion. This is certainly a point which needs further elaboration in future work.

APPENDIX: DEFINITIONS AND SOURCES OF VARIABLES

	Variable	*Source*
Social expenditure	Total public and mandatory private social expenditure as a percentage of GDP	OECD Social Expenditure Database
GDP growth	Growth of real GDP	OECD Economic Outlook Database
Unemployment	Standardized rate of unemployment	OECD Economic Outlook Database
Old age	Share of the elderly (65+) as a percentage of total population	OECD Health Data
Trade dependence	Sum of exports and imports as percentage of nominal GDP	OECD Economic Outlook Database
Maastricht	Dummy for signatory states of the Maastricht Treaty, 1993ff.	Own assessment
Social insurance as percentage of taxes	Social security contributions as percentage of GDP divided by total tax revenues as percentage of GDP	OECD Revenue Statistics (various issues)
Fractionalization	Fractionalization of party system (Rae index)	Armingeon *et al.* (2000)
Leftist government	Cabinet share of communist, social democratic and green parties	Schmidt *et al.* (2000)
Christian democratic government	Cabinet share of Christian democratic parties	Schmidt *et al.* (2000)
Institutional rigidity	Sum of index of bicameralism (1971–96) and index of federalism (1971–96)	Lijphart (1999: 313–14)

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Final version accepted for publication 29/7/02