PART I

WELFARE PRODUCTION REGIMES
Chapter One:

A Political Economy
Approach to the Welfare State

Printing is one of the world’s oldest industries, and typography is one of the oldest occupations in the industrial economy. Typographers transformed stacks of typed and handwritten manuscripts into a form that allowed for the mass-production of books, newspapers, and journals. Half technicians, half craftsmen, they were highly skilled, well paid, and proud harbingers of Gutenberg’s revolutionary invention. However, the craft was radically transformed over time: first from “hot-metal” typesetting to “analog” type-setting and then to digital CRT (Cathode Ray Tube) and laser image-setting. In the process of change, previous typesetting skills were swept aside in a matter of a decade or two, and large numbers of typesetters and other printing production workers were made obsolete -- many by an invention that the printed word helped set in motion: the computer. Lead molds, printing plates and all the other specialized equipment that went into previous printing processes were retired to the dusty shelves of industry museums. But retirement was not an option for the majority of typographers whose livelihood depended on using their skills acquired though long apprenticeships and years learning by doing.

The depth of desperation these workers felt as the industry was transformed can be conceptualized as a product of the non-transferability of their skills and the speed with which their skills were made obsolete by new technology, minus the availability of unemployment benefits, public health insurance, pensions, retraining programs, job creation, etc. that cushioned the effects of skill redundancy. And this formula for desperation or insecurity can, of course, be applied not just to typographers but to all workers – past, present and future – who have skills that are limited in application and can be made obsolete by new technology or other forces of change. Even social
scientists are subject to this logic. If it was not for the institution of tenure, many Kremlinologists would have been in trouble following the collapse of the Soviet Union.

This illustrates a central theme of this book: the importance of political and economic institutions for protecting the skills in which people have invested, or protecting against the effects of skills that are rendered obsolete. Job protection, unemployment benefits, income protection, and a host of related policies such as public retraining programs and industry subsidies, all help to insure workers against the loss of asset values when external shocks in technology and labor market conditions shift the demand for skills. Indeed, having some form of protection in place is a precondition for people making investments in specific skills in the first place. High job security, wage protection backed by union power, and guaranteed health and pension benefits encouraged generations of young people to choose typography as their trade. And, needless to say, the printing industry depended on people willing to invest in specific skills without having to pay exorbitant (“risk-adjusted”) wages. Likewise, the acquisition of specialized knowledge in academia, including that by Kremlinologists, would be very risky without some form of job security, and specialized knowledge is the lifeblood of the major research institutions (as opposed to teaching colleges). Even if the institution of tenure was invented as a response to the Red Scare in the 1920s, its persistence owes much to the fact that it is functional to the production of new knowledge.

But social protection is not only about insurance, it is also about redistribution and political conflict. When printers’ unions went on strike across the industrialized world in the 1970s, it was to ensure their own jobs and income, not the reproduction of old typographical skills. Everyone understood that traditional typesetting as a trade was doomed and that protection of current workers served largely distributive purposes. For the unions it was a matter of survival, and bitter battles, sometimes violent, broke out over the introduction of new technology and the retention of typographical workers. It is therefore no accident that the first publishing houses to introduce new technology, such as LA Times and Oklahoma City Times, were those with the weakest unions.
The ability of management to introduce radical new technology is clearly undermined by strong unions and labor market regulation. Indeed, the notion that these institutions, and the welfare state more generally, erode the market is widespread among both neo-classical economists and political sociologists. In Esping-Andersen’s apt terminology the welfare state is “politics against markets,” and the process whereby markets are replaced by the state is called de-commodification (Esping-Andersen 1985, 1990). This view is supported by the common argument that the rise of the labor movement, coupled with the extension of the franchise, were accompanied by pressure to temper the inequalizing effects of the market and to reduce workers’ from dependence on the market. As widely argued, workers want de-commodification while employers oppose it, and the historical strength of the political left, mediated by alliances with the middle classes, determine how much welfare state and how much market different countries end up with (Korpi 1983, 1989; Esping-Andersen 1990; Huber and Stephens 2001).

This is a powerful image and one that holds important elements of truth. Indeed, distributive politics will be an important part of the story told in this book. But it is not the whole story, and it is one that can easily mislead if not balanced by one about the insurance aspects of the welfare state and the (conditional) support of employers and workers alike. Recent research by Peter Swenson, for example, suggests that employers played a very pro-active role in the early formation of social policy. Swenson argues that in tight labor markets employers will seek to take social benefits out of competition by creating a uniform, national social insurance system (Swenson 2002). When labor markets face slack, high-cost producers may feel compelled to impose costs on low cost producers through mandatory social insurance arrangements. Swenson argues that the first logic helps explain early welfare reforms in Sweden, while the latter helps explain salient features of the New Deal legislation in the United States.

In a similar vein, Isabela Mares has argued that companies and industries that are highly exposed to risks will favor a social insurance system where costs and risks are shared, leading these employers to push universalistic unemployment and accident insurance (Mares 2003). This is remarkable because universalism is usually associated with strong unions and left governments.
Mares also suggests, and this is something emphasized in this book, that social protection may encourage the acquisition of skills in the labor force, which in turn enhances the ability of some firms to compete in international markets. This has led, for example, to some high-skill firms favoring generous unemployment insurance.

In a recent dissertation on the German welfare state, Philip Manow has likewise advanced the thesis that the German system of social protection, through a process of institutional co-evolution, emerged as an important complement to the collective bargaining system, which in turn underwrote union wage restraint and international competitiveness (Manow 2002). By delegating much of the responsibility for social policy to the social partners, the inability of the German state (as a result of federalism, an independent central bank, etc.) to guarantee full employment was compensated for by a social system that could provide very high levels of insurance in the event of unemployment and other shocks to income.

The work by Mares, Swenson, Manow and others point to the need for a more sophisticated understanding of “the market” than is common in the welfare state literature. A “politics of markets” rather than a “politics against markets”. Most market exchanges expose people to risks that must be managed in order for the exchanges to take place in the first place. Douglas North (1990) has described how in local trading communities, before the advent of modern capitalism, this was accomplished through dense networks of people who knew each other well and engaged in repeated interaction.¹ In non-localized exchanges monitoring is harder, and markets left to their own devices will either fail to produce any transactions other than simple barter trade, or they will be accompanied by costly and continuous haggling (North 1990). As is now well understood, efficient markets require institutions that provide information, permit complex contracting, and ensure impartial enforcement (Polanyi 1944; Williamson 1985).

¹ Marshall’s concept of industrial districts likewise emphasizes repeated interactions in localized settings as a precondition for efficient outcomes (Marshall 1922).
Nowhere is the importance of institutions more evident than in the labor market where the welfare state plays a key mediating role. Again, social protection is particularly important in solving market failures in the formation of skills. Without implicit agreements for long-term employment and real wage stability, investment in skills that are specific to particular jobs, firms, or industries will be sub-optimal. In the absence of insurance, workers shun such investments because unanticipated shocks to the economy, whether due to recessions or technological change, can prevent workers from reaping the returns on their investments. Employers will also be reluctant to invest in their employees’ skills, or equipment that requires those skills, unless they believe that institutions are in place which prevent poaching and discourage unions from exploiting the potential holdup power that specific skills confer.

The importance of asset specificity is already well understood in other policy areas. For example, property owners will be more inclined to hold their wealth in liquid assets that can be quickly moved from one jurisdiction to another when there is little credible protection of property rights (Bates, Brock, and Tiefenthaler 1991). Even when basic property rights are well protected, investments vary significantly in the degree of their asset specificity. When investors cannot trust suppliers or employees on whose cooperation they depend, they will shun investments in relation-specific assets and rely instead on anonymous market transactions where one supplier or employee can easily be replaced by another. Conversely, when investments in physical assets are specific to a particular location, supplier network, or employee relationship, firms are more prone to lobby the state for protection against uninsurable risks (see Alt et al. 1999).²

The exact same logic applies to human capital. When skills are specific to a particular firm, industry or occupation, their owners are exposed to risks for which they will seek non-market protection. Skills that are portable, by contrast, do not require extensive non-market protection, and when there is little protection, investing in such skills is the best insurance against adverse

² Alt et al. (1999) show empirical evidence that lobbying rises with the asset specificity of industries. See also Alt et al. (1996) for a more theoretical treatment of this and related arguments concerning the importance of asset specificity.
market conditions and technological change. But despite its intuitive appeal, asset specificity plays virtually no role in existing explanations of the welfare state. Implicitly, it is assumed that skill assets are either not financially important, or that they have no discernable effect on people’s preferences for social protection.

Such assumptions are unwarranted. Consider first the value of skills as assets. In 1999, American workers over the age of 25 with a four-year college degree earned an average of $47,400 dollars compared to $26,500 by workers with a high school degree and $16,900 by workers who had less than a high school degree (US Census Bureau 2000). Ignoring other group differences, having a college degree is equivalent to a three percent real return on a net fortune of about $925,000 (compared to someone with less than a high school degree). For comparison, the median net worth of an American household, most of which is tied up in real estate wealth, is $53,000 (Wolff 1998).³ And, of course, some of this wealth reflects accumulated past returns on skills. Human capital is, thus, easily the most import asset for a majority of people.

Do people also worry about losing the value of their assets? The answer obviously varies from individual to individual according to the level and mobility of their skills, but many face a non-trivial risk that their training can be made partially or entirely redundant by new technology or other forces of change (as in the example of typographers above). Taken as a whole, manufacturing employment has been cut in half since the 1960s, and a large portion of the jobs that remain require substantially different skills than in the past. Although hard to quantify, there is every reason for skilled workers and their unions to concern themselves with insurance against income losses as a result of obsolete skills.⁴ And such insurance cannot be provided through the market due to insurmountable problems of moral hazard, adverse selection, and other market

³ These are 1995 numbers expressed in 1999 dollars.

⁴ One of the difficulties of quantifying the specificity of skills is that wage and social protection systems are set up to reduce the riskiness of specific skills. Skill certification and wage standardization by skill categories, for example, are a way for unions to prevent individual workers from experiencing large drops in income. Variability of wages is therefore not an indicator of asset specificity. Chapter Three goes to considerable length in developing alternative measures of skill specificity and to tie such specificity to social policy preferences.
failures. Historically, very little unemployment insurance has been provided privately, and while insurance companies will sell you a health insurance, there is no effective insurance against losing your ability to pay for the insurance. For the majority of people, insurance against job and income loss comes from private savings or, more likely, from the state.

It is also the case that employers who are pursuing product market strategies that require specific skills have a vested interest in social policies that reduce the risk of acquiring those skills (Mares 1998; 2001; Swenson 2002; Estevez-Abe 1999a). The focus on employers, however, tends to leave the democratic state, electoral politics in particular, under-explored. The power of employers is primarily “structural” in nature, but governments have to win elections to stay in power, and it cannot be assumed the electoral incentives of politicians are perfectly aligned with their economic incentives (Elkin 1985; Block 1994). In Swenson’s (1998) account of the New Deal, for example, politicians are faithful representatives of employers’ long-term interests, yet they face an urgent need to accommodate popular demands for political action. Indeed, Swenson acknowledges that business often oppose such action, yet it somehow ends up benefiting from it. One of the great strengths of the power resources model was that it had a credible account of electoral politics, even if it did not have a very refined model of the economy. A key aim of this book is to bring electoral politics back to center stage in a literature that has become richer in its understanding of production politics and employer interests, but leaves mass politics largely unexplored.

Explaining voter preferences and how these are translated into policies thus stand at the center of my analysis. Chapter Three, for example, presents a model of social policy preferences based entirely on peoples’ assets. Translating these preferences into policies, however, raises an aggregation problem. Simply put, since social insurance may only be enjoyed by the current median voter some time in the future, the median voter has an incentive to support such insurance only if future median voters do the same since these voters will set policy in the future. The

---

5 See Hacker and Pierson (2002) for an extensive critique of Swenson and related work on the role employers in the rise of the welfare state.
current median voter, therefore, faces a problem of how to commit future median voters. This translates into a *time-inconsistency problem* for the government because it has an incentive to renege on its promise to the current median voter when it seeks to attract the support of the future median voter. Again, the reason is that the median voter at any given time, when choosing a policy for the present, does not have an interest in high transfers. This problem is addressed in Chapter Four, which argues that the structure of electoral systems and the organization of political parties and unions solve the intertemporal commitment problem.

1.1. *The Welfare-Skill Formation Nexus: Some Key Distinctions*\(^6\)

Assuming that skills and welfare are linked, what is the nature of the relationship between particular types of skills and particular types of social protection? One way to approach the question is from the perspective of individuals making career choices. Early in their careers, people invest in skills through tuition and fees and by foregoing income during training. Since much skill acquisition requires several years of training, it is sensible to assume that some effort will go into choosing an appropriate career. While this calculation will vary across individuals according to ability and other individual traits, at the macro-level there will be a systematic effect on the *distribution* of skill investments from institutions that affect the riskiness of these investments.

Alternatively, one can ask what type of protection a worker with a particular skill set would rationally want. Following Estevez et al. (2001), which builds on Becker (1964), I distinguish between firm-specific, industry-specific, and general skills. Firm-specific skills are, *ex hypothesi*, worthless outside that specific firm, and workers will, therefore, be reluctant to invest in these unless they have some insurance that they will stay with the firm for a long time (Aoki 1988). Since workers will only be paid the value of their non-firm-specific skills in the external market, the greater their investment in specific skills the greater the discrepancy between current wages and the wages they could fetch in the external market. In order to invest heavily in firm-specific

---

\(^6\) This section is based on Estevez et al. (2000).
skills, workers, therefore, need assurances that they can remain in the company for a long enough period to reap the returns on such investments (see Lazear and Freeman 1996; Osterman 1987; Schettkat 1993). Such assurances are called employment protection.

For industry-specific skills, employment protection per se matters less. If skills are truly specific only to the industry and not the firm, workers can in principle move between firms without loss of income. Instead, what becomes important for workers' incentives to invest is the protection of "skilled wages" regardless of employment status. Unemployment protection achieves this in part by securing earnings-related benefits and also by helping to keep the skilled wages high even when the supply of skills exceeds the demand for those skills. Generous unemployment protection is also important in so far as it allows workers to turn down job offers outside their previous industry or occupation. If compelled to accept a job offer outside the worker's core competencies, the worker's incentives to invest in industry-specific skills are undermined.

---

7 It should be noted here that this argument appears to conflict with Becker’s (1964) famous proposition that companies will pay fully for company-specific skills, since they need to pay only marginally above the market wage for the employee’s marketable skills in order to retain the employee, and can thus appropriate the full return on the investment.

Becker's argument, however, makes two critical assumptions that are not generally satisfied. The first is that the acquisition of company-specific skills does not reduce the maximum present value of the employee’s marketable skills, either marketable skills which the employee currently possesses or marketable skills in which the employee will invest in at some future point. This assumption is reasonable where relatively minor specific-skills are concerned -- for example, the understanding of specific office routines or software that is customized for the company. It is implausible where the company-specific skills constitute a major part of the employee’s skill portfolio. There are two main reasons.

First, the greater the proportion of company-specific skills, the less likely is the employee to use preexisting marketable skills; since most skills are maintained by use, refreshment and updating, the employee’s marketable skills will deteriorate. Second, after full-time education, a large proportion of marketable skills are acquired by most employees at low cost during their employment by doing different jobs (often within the same company) and being taught, for example, the different software packages which each job requires. If a company, however, invests heavily in an employee's company-specific skills, the company is likely to want the employee to focus on using those skills, hence not to move around.

A second critical assumption which Becker makes is that company-specific skills confer no “hold-up” power on employees. If they do, as is often the case, then the ability of companies to appropriate the full return no longer holds, and then companies will seek credible guarantees from its workforce. This typically involves cooperative arrangements with unions, such as works councils, which in turn is made possible because employees have made investments in company-specific assets. In order to encourage employees to make these investments, employees require some measure of credible protection.
If there is little protection built into either the employment or the unemployment system, the best insurance against labor market risks for the worker is to invest in general, or portable, skills that are highly employable in the external labor market and, therefore, can be easily redeployed. If general skills are what firms need for pursuing their product market strategies successfully, low employment protection can thus give these firms a competitive edge. Conversely, if most firms are pursuing general skills strategies, higher protection would be inefficient because it undermines workers’ incentives to invest in these skills, without significantly increasing their propensity to acquire specific skills because demand for skills is determined by firms specializing in production using labor with predominantly general skills. This is the logic of a general skills equilibrium.

Unemployment and employment protection provide valuable insurance against the effects of short and medium term cycles in the economy. But, for most people they do not offer effective protection against technological and other structural changes that significantly alter the employability of particular skills. If a firm experiences a permanent shift in its need for certain skilled workers, it might try to reduce their wages or eventually lay off these workers despite the high costs of doing so. Also, unemployment benefits eventually run out and workers are not always able to find another job requiring the same qualifications. For these reasons non-transferable skills must also be insured directly against loss of income. I refer to this kind of insurance as income protection.

The natural interpretation of income protection through wages is that it provides a broadly stable proportionate distribution of earnings across different occupations. Institutionally we would thus expect to find coordinated wage setting systems in economies where specific skills are important, and non-coordinated systems where they are not. And in terms of outcomes we would expect to find stable distributions of earnings across occupations in the former, but not necessarily the latter case. The wage determination system should, thus, be viewed by political economists not just in macroeconomic terms, but as a critical linking institution between the welfare state and the
production regime. In most of the welfare state literature the wage-setting system is simply ignored, although it is a significant part of the social protection system for many workers.\(^8\)

There is, however, an important complication to this analysis, which can best be understood by making a distinction between *income protection for the employed* and *income protection for the unemployed*. For the employed income protection means simply that wages do not fall out of line with wages in other occupations. For the unemployed, a natural definition of income protection is that there is some guarantee that the income at which the unemployed person is rehired is the same as, or at least not radically lower than, the income at which he or she was previously employed. High unemployment protection complement such a system by keeping up income between jobs.

Income protection for the unemployed is a much more encompassing concept than the label may seem to suggest, and it is important to understand it. It is partly secured through the collective bargaining system by setting standard rates for particular skill or occupational categories. However, this system can only go so far since rigid wages may prevent people with non-transferable skills from ever finding another job. This is particularly true when layoffs are not cyclical in nature but the result of structural change in the economy (new technology, changing tastes, etc). In this case non-wage income from the social transfer system becomes a critical complement to wages, cushioning the income effects of movement between jobs with different skill requirements. Publicly provided healthcare insurance, pensions and other transfers are typically far less variant than the skill requirements of different jobs. Although many social benefits are earnings and occupation related, detailed income data from the Luxembourg Income Study shows that the social transfer system *always* distributes cash benefits in a fashion that reduces pre-tax and transfer income inequalities (Bradley et al. 2002). Hence, the larger the percentage of income derived from transfers, the less sensitive net income is to changes in market earnings. In addition, one category of spending, early retirement, which has been rising sharply in

---

\(^8\) For a critique of the welfare state literature that emphasize the need to consider protection outside the state, see Kitschelt (2001).
many countries, cushions older workers with deep, but increasingly redundant, skills from the risk of permanent unemployment. In fact, early retirement is often simply a superior alternative to long-term unemployment benefits.

The relationship between the two types of income protection and skills is similar to the relationship between skills and employment and unemployment protection, and is summarized in Figure 1.1. For a mix of firm and industry skills, income protection for the employed and income protection for the unemployed both need to be high. These relationships will be quantified in subsequent chapters, but a good example is Germany where employment protection is high, the unemployment and wider transfer system generous, and the vocational training system is designed to place equal weight on the provision of firm and industry skills. By contrast, the incentive to invest in general skills are greatest when protection is low across the board. In comparative perspective, the case that comes closest to this model is the US, which simultaneously exhibits one of the best systems of higher education and one of the worst systems of vocational training.

Some cases cannot be classified along a simple scale from more to less, but feature particular mixes of social protection with their own distinctive skill profiles. When there is little job protection but high protection for workers moving between jobs, the incentive to invest in industry- or occupation-specific skills is high, but the incentive to invest in narrow firm-specific skills is low. Denmark, characterized by small firms with limited capacity to commit to long-term employment but relying on a workforce with excellent industry and craft-based skills, comes closest to this ideal type. Finally, in the case of heavy reliance on firm-specific skills, high long-term employment for skilled workers, seniority-based job and wage ladders are essential. If an employee has “lifetime” employment and employed wage protection guarantee, at least so long as he works effectively, this constitutes an effective incentive for the potentially responsible employee to invest appropriately in company-specific skills. Low unemployment and unemployed income protection serve as a disincentive to leave the company or to work in such a
Figure 1.1. Social protection and predicted skill profiles.

<table>
<thead>
<tr>
<th>Unemployment protection and income protection for the employed</th>
<th>Employment protection and income protection for the employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Industry-specific skills</td>
<td>Industry-specific, firm-specific skill mix</td>
</tr>
<tr>
<td>Example: Denmark</td>
<td>Example: Germany</td>
</tr>
<tr>
<td>General skills</td>
<td>Firm-specific skills</td>
</tr>
<tr>
<td>Example: United States</td>
<td>Example: Japan</td>
</tr>
</tbody>
</table>

way as might lead to dismissal. The reader will recognize the similarities of this model to key aspects of the Japanese system.

The coupling of social protection and skill systems helps us understand the product market strategies of companies and the creation of comparative advantages in the global economy. Thus, where there is a large pool of workers with advanced and highly portable skills and where social protection is low, companies enjoy considerable flexibility in attracting new workers, laying off old ones, or starting new production lines. This flexibility allows for high responsiveness to new business opportunities and facilitates the use of rapid product innovation strategies. Such capacities are lower for firms in economies that rely heavily on non-transferable skills and that protect these skills through restrictions on the ability of firms to hire and fire workers. On the other hand, these types of welfare-production regimes give a comparative advantage to companies that compete in markets where there is a premium on the ability to develop deep competencies within established technologies and to continuously upgrade and diversify existing product lines -- what Wolfgang Streeck in a seminal article has dubbed “diversified quality production” (Streeck
Based on gross unemployment replacement rates published in OECD’s Database on Unemployment Benefit Entitlements and Replacement Rates (undated).

Chapter Two will develop the linkages between production technologies, welfare production regimes, and the international division of labor in greater detail.

It is important to note that the international division of labor not only perpetuates particular product market strategies, but is likely to also feed back into political support for existing social protection regimes. Contrary to the popular notion of a social “race to the bottom,” differences across countries should, therefore, be expected to persist and even be deepened by the international division of labor -- a proposition implied by Hall and Soskice’s concept of comparative institutional advantage (Hall and Soskice 2001). For example, from the 1970s to the 1980s and 1990s, unemployment benefits remained stable or rose in most continental European countries, but they were cut in Ireland and all the Anglo-Saxon countries with the exception of Australia. Moreover, whereas labor markets have become even more deregulated in the latter countries, employment protection for full time employees has remained high in the former (OECD 1999).

Yet, the reform of labor markets and welfare states in some high protection countries also poses several puzzles from this perspective. Thus, several continental European countries have seen a notable relaxation in the protection of temporary and part-time employment in recent years. What explains this bifurcation in the protection system between full- and part-time employees, if the comparative institutional advantage argument is correct? I shall later argue that the answer must be found in the lack of anything that approaches a complete international division of labor in services; in other words, the exact opposite of globalization. When there are barriers to specialization, countries cannot reap the full benefits of their institutional advantage. Employment suffers and governments begin to experiment with policies to deregulate part of the labor market. Separating the protection system for full time employees from that of part-time and temporary employees becomes one of the vehicles.

---

9 Based on gross unemployment replacement rates published in OECD’s Database on Unemployment Benefit Entitlements and Replacement Rates (undated).
1.2. Broader Implications of the argument

The argument presented above focuses on the efficiency aspects of social protection. Does it also have something to say about distribution? In this section I argue that the core argument can be extended to unravel three sets of previously neglected logics by which welfare production regimes affect distribution. First, general skill systems are more likely to generate wage inequality and "poverty traps" because they limit opportunities and incentives for skill acquisition at the low end of the academic ability distribution. Secondly, gender inequality in the labor market is intimately related to skill and social protection regimes, and such inequality, contrary to wage inequality, tends to be higher in specific skills systems. The reason is that women have lower capacity than men to commit to uninterrupted careers, which is important in specific skills systems. Finally, demand for insurance against social risks leads to significant redistribution of income through the welfare state. All in all, specific skills systems tend to be notably more egalitarian and redistributive than general skills systems, but labor markets in these countries tend to be more gender segregated.

1.2.1. Skills and wage inequality.

It is striking, though not surprising, that all countries with a strong emphasis on industry-specific skills have developed effective wage coordination at the industry level. Conversely, general skills countries, and countries with a strong emphasis on firm-specific skills (Japan in particular), lack such coordination. Very extensive evidence has now been accumulated that demonstrates the importance of the structure of the wage bargaining system for the wage structure (see especially Rowthorn 1993; Iversen 1999; Wallerstein 1999; and Reuda and Pontusson 2000). As implied by the argument, intra-occupational compression of wages serves as a complement to employment and unemployment protection because it helps insure against a big drop in income if a worker loses her job. Collective bargaining at the industry or higher levels also gives low income groups influence over the distribution of wages that they lack in the market. Such influence tends to promote equality.\textsuperscript{10}

\textsuperscript{10} However, this also reduces wage differentials between skills categories, which is contrary to the goal of maintaining high wage protection for the employed (i.e., maintaining stable wage differentials across occupations).
But the skill system itself is equally important as illustrated in Figure 1.2. The graph uses the incidence of vocational training as an indicator of the extent to which workers are acquiring specific vocational skills as opposed to general academic skills (measures of skills will be discussed extensively in subsequent chapters). Note the strong empirical association between skills and earnings equality. Because specific skills systems generate high demand for workers.

Figure 1.2. Vocational training and wage inequality

Notes: a) The earnings of worker in the top decile of the earnings distribution relative to a worker in the bottom decile of the earnings distribution; b) The share of an age cohort in either secondary or post-secondary (ISCED5) vocational training. Source: UNESCO (1999).

Source: OECD, Electronic Data Base on Wage Dispersion. Undated.

The problem was particularly great in Sweden, and led to a revolt against centralized (though not coordinated) bargaining among skilled workers and their employers (Iversen 1996; Pontusson and Swenson 1996).
The estimated regression equation is:

\[ \text{Income equality} = 0.23 + 0.048 \times \text{Specific skills} + 0.055 \times \text{Industry coordination} , \text{ where } R^2 = 0.69 \]

with good vocational training, young people who are not academically inclined enjoy career opportunities that are largely missing in general skills systems. Whereas a large proportion of early school leavers in the former acquire valuable skills through the vocational training system, in the latter most early school leavers end up as low-paid unskilled workers for most or all of their working lives.

In combination, the wage bargaining system (i.e., whether it is industry coordinated or not) and the skill system (i.e., whether it is specific skills or general skills biased) provide a powerful explanation of earnings inequality as illustrated in Table 1.1. The table shows figures for earnings and income inequality for each combination of bargaining and skill system. Note that the big increase in earnings inequality occurs as we move from skill systems with industry-coordinated bargaining to general skills systems without industry-coordinated bargaining. By themselves this pair of dichotomized variables account for nearly 70 percent of the cross-national variance in income inequality.\(^{11}\) Again, this points to the importance for studies of social protection to pay attention to factors outside the welfare state that affect distribution. Much of the welfare state literature fails to do this, notwithstanding the focus on distribution in that literature. In the theoretical framework presented here, they are integral parts of the story even though insurance is as important to the story as distribution.

The hypothesized relationship between product market strategies, skill composition, and equality points to another, quite different, source of evidence: the distribution of academic test scores. The reason is that specific skills systems create strong incentives among young school goers to do as well as they can in school in order to get the best vocational training spots, whereas those at the bottom of the academic ability distribution in general skills systems have few such incentives.

More specifically, for students in the bottom one third, or so, of the academic ability distribution, a highly developed vocational training system offers the best opportunities to acquire skills that

\(^{11}\) The estimated regression equation is:

\[ \text{Income equality} = 0.23 + 0.048 \times \text{Specific skills} + 0.055 \times \text{Industry coordination} , \text{ where } R^2 = 0.69 \]
Table 1.1. Skills, the bargaining system, and equality\textsuperscript{a}

<table>
<thead>
<tr>
<th>Wage bargaining system</th>
<th>Industry coordinated</th>
<th>Not industry coordinated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biased towards specific skills</td>
<td>.49 (.34) (N=9)\textsuperscript{b}</td>
<td>.34 (.28) (N=3)\textsuperscript{c}</td>
</tr>
<tr>
<td>Biased towards general skills</td>
<td></td>
<td>.29 (.23) (N=6)\textsuperscript{d}</td>
</tr>
</tbody>
</table>

Notes: \textsuperscript{a} Numbers are D1/D9 earnings ratios based on gross earnings (including all employer contributions for pensions, social security etc.) of a worker at the bottom decile of the earnings distribution relative to the worker at the top decile. Figures are averages for the period 1977-1993. Numbers in parentheses are D1/D9 income ratios based on disposable income of a person at the bottom decile of the earnings distribution relative to a person at the top decile. Most figures are from the early 1990s, with a few from the 1980s. \textsuperscript{b} Austria, Belgium, Denmark, Finland, Germany, Netherlands, Norway, Sweden, Switzerland. \textsuperscript{c} France, Italy, Japan. \textsuperscript{d} Australia, Canada, Ireland, New Zealand, UK, US.

Sources: Skills: Explained in Chapter Two; bargaining system: see Iversen (1999, ch. 3); inequality measures: OECD Employment Outlook (1991, 1996); Gottschalk and Smeeding (2000), Figure 2.

are valued by employers. When entry into vocational training is competitive, these students have an incentive to be as good as they can academically in order to get into the best training programs with the most promising career prospects (Soskice 1994). Therefore, countries with well-developed (and competitive) vocational training systems provide stable economic future even to those students who are not academically strong. General education systems, in contrast, offer these students relatively few opportunities for improving their labor market value outside of the school system. As a result, there are fewer incentives for them to work hard inside the school system.
Moreover, in firm-specific skill training systems, employers develop strong stakes in overseeing the quality of potential employees (i.e. trainees) and developing clear job entry patterns.\textsuperscript{12}

Because employers are committed to making significant initial human capital investment in new job entrants, they will be interested in monitoring the quality of the pool of the new school leavers. As a result, they are likely to establish a working relationship with various schools for systematic hiring of new school leavers. Since employers in a firm-specific skill system carry out initial job training, new school graduates have a chance of building careers as skilled workers. This gives young school goers an added incentive to work hard in school. The “from-school-to-work” transition is likely to be more institutionalized (Dore and Sako 1989). Similarly, in the case of industry-specific skills where employers are involved, employers take an interest in ensuring the quality of vocational training and the certification of skills (Finegold and Soskice 1988). In these systems, the education-work transition is also relatively institutionalized (Ni Cheallaigh 1995; Blossfeld 1987).

In general skill regimes, by contrast, the "from-school-to-work" transition is less institutionalized (see Allmendinger 1989), and hiring is more flexible. Employers hire new job entrants with different educational backgrounds. Promotion and opportunities for further skill training are themselves contingent upon the job performance of the worker. There is not so much initial human capital investment by employers as there is in firm-specific skill systems. Because of the absence of a clear vocational track, systems based on general skills tend to disadvantage those who are not academically inclined. Regardless of the presence or absence of vocational schools and apprenticeship programs, for employers who emphasize general skills, a certificate from a vocational school does not add much value to the worker. Potential workers, therefore, have to demonstrate their competence in terms of general scholarly achievement and getting a tertiary degree becomes an essential component. Because there is a hierarchy of post-secondary schools,  

\textsuperscript{12} It is worth noting that monitoring the quality of the general education system becomes important where a lot of human capital investment takes place beyond the general education system, because poor general education increases the cost of training workers in industry-specific and firm-specific skills.
if the student thinks there is a possibility of making it into the tertiary educational system, he or she has a strong incentive to work hard. For those who are not academically inclined, however, the system produces the unintended consequence of undermining the incentive to work hard in school.

There is evidence of this logic in international comparisons of academic test scores where the expectation is that the number of adults failing internationally standardized tests is higher in general skills countries than in specific skills countries. Although the data are limited in coverage, this is, in fact, what we observe (see Figure 1.3). Whereas the percentage failing the test varies between 15 and 22 percent in the Anglo-Saxon countries, it is only between 8 and 14 in the countries emphasizing more specific skills for which data are available. Although these differences could be due to the overall quality of the educational system (which may itself be a reflection of the broader production system), it is not the case that the Anglo Saxon countries spend less money on primary education, and there is no systematic difference in average scores. This points to the importance of incentives outside the school system.

1.2.2. Skills and gender inequality

General skills systems are not necessarily bad for all types of labor market inequality. In fact, such systems perform better in terms of gender equality at work (Estevez-Abe 1999b; Porter 2002), and this presents an important puzzle for studies of inequality. In this section I built on especially Estevez-Abe (1999b) to show how the skill argument shed light on this issue.

When we compare access to private sector jobs, especially high-skilled ones, specific-skills systems tend to exhibit more occupational segregation than general skills systems. Labor force surveys confirm this general tendency. For example, in Norway and Germany roughly 75 percent of employed women can be classified in one of ten occupational groups, while in the United States, Australia, and the United Kingdom, the number is around 60 percent (Porter 2002, ch. 2). Moreover, existing labor force data almost certainly underestimate actual segregation because they do not distinguish between private and public sector jobs. This is
important because public employers are often motivated by political considerations to hire in a fashion that offsets inequalities produced in the private labor market. This in turn disguises skill-induced inequalities in the aggregate data, even though the inequalities may be the reason behind the policies.

To overcome this problem, Table 1.2 uses data from the International Social Survey Program, which classifies individuals according to both occupation and sector. The table shows the share of women in three broad categories of private sector occupations. The data are from 1997 and
### Table 1.2. The share of women in different occupational classes (percent; N in parentheses).

<table>
<thead>
<tr>
<th></th>
<th>Managers and professionals</th>
<th>Clerks, service, and unskilled workers</th>
<th>Craft and skilled workers</th>
<th>Average, private sector</th>
<th>Public Sector</th>
<th>Female participation rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norway</td>
<td>28</td>
<td>76</td>
<td>7</td>
<td>27</td>
<td>83</td>
<td>76</td>
</tr>
<tr>
<td></td>
<td>(70)</td>
<td>(172)</td>
<td>(427)</td>
<td>(860)</td>
<td>(960)</td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>11</td>
<td>69</td>
<td>5</td>
<td>16</td>
<td>81</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td>(386)</td>
<td>(118)</td>
<td>(403)</td>
<td>(928)</td>
<td>(632)</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>40</td>
<td>65</td>
<td>12</td>
<td>40</td>
<td>68</td>
<td>76</td>
</tr>
<tr>
<td></td>
<td>(94)</td>
<td>(69)</td>
<td>(67)</td>
<td>(234)</td>
<td>(194)</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>34</td>
<td>63</td>
<td>9</td>
<td>36</td>
<td>48</td>
<td>64</td>
</tr>
<tr>
<td></td>
<td>(137)</td>
<td>(97)</td>
<td>(90)</td>
<td>(333)</td>
<td>(134)</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>40</td>
<td>44</td>
<td>19</td>
<td>33</td>
<td>40</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>(219)</td>
<td>(140)</td>
<td>(125)</td>
<td>(345)</td>
<td>(129)</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>38</td>
<td>79</td>
<td>25</td>
<td>29</td>
<td>36</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>(140)</td>
<td>(577)</td>
<td>(157)</td>
<td>(195)</td>
<td>(76)</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>64</td>
<td>85</td>
<td>16</td>
<td>64</td>
<td>40</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>(780)</td>
<td>(552)</td>
<td>(233)</td>
<td>(1557)</td>
<td>(88)</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>48</td>
<td>75</td>
<td>4</td>
<td>26</td>
<td>23</td>
<td>62</td>
</tr>
<tr>
<td></td>
<td>(159)</td>
<td>(59)</td>
<td>(327)</td>
<td>(565)</td>
<td>(424)</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>52</td>
<td>56</td>
<td>5</td>
<td>46</td>
<td>54</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>(267)</td>
<td>(103)</td>
<td>(36)</td>
<td>(227)</td>
<td>(183)</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>58</td>
<td>69</td>
<td>24</td>
<td>56</td>
<td>-</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td>(320)</td>
<td>(274)</td>
<td>(139)</td>
<td>(531)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>45</td>
<td>77</td>
<td>33</td>
<td>55</td>
<td>73</td>
<td>68</td>
</tr>
<tr>
<td></td>
<td>(155)</td>
<td>(198)</td>
<td>(131)</td>
<td>(484)</td>
<td>(199)</td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>41</td>
<td>82</td>
<td>6</td>
<td>50</td>
<td>91</td>
<td>68</td>
</tr>
<tr>
<td></td>
<td>(56)</td>
<td>(33)</td>
<td>(34)</td>
<td>(709)</td>
<td>(329)</td>
<td></td>
</tr>
</tbody>
</table>

**Mean** 42 70 14 41 58 66

*Note:* For most countries the occupational classification is based on ISCO-88. For Italy and Spain it is based on ISCO-67 converted into ISCO-88. In the case of Britain, a national classification scheme is used which is converted into ISCO-88 categories: Managers and professionals: ISCO-88 1-3; (2) clerks, service and unskilled workers: ISCO-88 4, 5, 9; Craft and skilled workers: ISCO-88 6-8.

cover 12 OECD countries (ISSP 2000). Unfortunately the accuracy of the data is much lower than labor force surveys, primarily as a result of small samples, so the individual numbers must be treated with caution. Regardless, they are sufficiently accurate to give us a sense of broad cross-national patterns of gender segregation.

First note that female employment in the private sector is strongly concentrated in low- and semi-skilled jobs. Women also tend to be overrepresented in the public sector – especially in countries where the public sector is service-intensive as in Scandinavia – while, on average, they are close to parity with men in the professions where qualifications are based on formal education. This is especially true in general skills countries like Canada and the US, though less true in specific skills countries like Norway and Sweden. Finally, women are everywhere almost completely excluded from high paid skilled jobs in industry. Only 14 percent of jobs are on average occupied by women in this category of jobs.

For comparative purposes the most telling numbers are the share of private sector jobs occupied by women. The sample size is here adequate to provide an overall impression of the relationship between training and the share of jobs occupied by women, as shown in Figure 1.4. Note that there is a specific skills cluster with a low share of women in the private sector and a general skills cluster in which women appear to have achieved parity, or close to parity, with men. Switzerland is a big outlier, but at least some of this deviation must be due to bias in the data because more reliable census data rule out the implication that women outnumber men in the labor market.

---

13 The countries chosen are among democracies at a roughly similar level of development. Two countries included in the survey, Japan and the Netherlands, either had no breakdown of workers by occupation (the Netherlands) or used a national classification scheme that was radically different from ILO’s International Standard Classification of Occupations used in other countries (Japan).

14 Note that comparisons across countries in this occupational category is haphazard given the small numbers.

15 The participation rate among men is about 20 percent higher than among women in Switzerland.
Even with the Swiss observation included, the correlation between vocational training activity and women’s share of private sector employment is -0.71 (without Switzerland it is -0.83).

Why do women find it harder to enter into specific skills jobs? The traditional literature on gender inequality does not provide a clear answer to this puzzle, but, as argued by Estevez-Abe, (1999b) there is an obvious explanation in the differential ability of men and women to commit to uninterrupted careers. In addition to the probability of layoff, women have to consider the likelihood of career interruption due to child birth and rearing (see Daly 1994; Rubery, Fagan and Maier 1996). For a woman to invest in specific skills, she has to be assured that potential career interruptions, if temporary, will not lead to dismissal or reduce her wage level in the long run. A high probability of dismissal reduces the incentives to acquire firm-specific skills. A high probability of reduction in wages after becoming a mother reduces the incentives to invest in either firm-specific or industry-specific skills.

As argued by Estevez-Abe, employment protection for women, therefore, necessarily involves two factors in addition to the employment and unemployment protection discussed earlier: (i) protection against dismissal during and after pregnancy, such as maternity, parental and family leave policies; and (ii) income maintenance during leaves and guarantees of reinstatement to the same job at the same wage level upon return to work. If the two are combined, the effect for working women would be similar to the effect of unemployment protection and wage protection for the unemployed.

However, generous leave policies also have the unintended consequence of making women workers’ commitments to uninterrupted careers less credible and thus undermining the incentive for employers to hire women (Porter 2002). In the case of firm-specific skills, there is the
additional problem that reinstatement to the original job after the leave means that women fall behind their male cohort in skill formation and promotion. Despite generous income replacement during the leave, time off due to child birth and rearing, therefore, reduces women’s overall earnings and career prospects.

From a woman’s perspective, this means that it does not pay to invest in specific skills for which there is an abundant supply of males. Even if a woman invests to acquire a specific skill, her
investment will not be protected to the same degree as men’s. Given this situation, women are more likely than men to invest in general skills and/or in skills that are less prone to deteriorate by not being used for some period of time (i.e., low atrophy rates). This implies a heavily gendered structure of educational choices, and it is not surprising that vocations with more general educational content and low atrophy rates such as commerce, services and home economics are overwhelmingly female in composition (Estevez-Abe 2002). At the same time the argument implies that at any given composition of skill investment, women will prefer more social protection. I examine both implications in Chapter Three.

At the low-skill end, women tend to dominate basic personal and social services. The cross-country difference is that these jobs are much more plentiful in the private sector in general skills countries where wage and employment flexibility promotes low-paid job creation. In specific skills countries with high job security and wage protection, low-skilled female jobs are only produced in large numbers if the state steps in to create them directly in the public sector, financed through higher taxes (Esping-Andersen 1990, 1999; Iversen and Wren 1998). The possibility of public provision of social services is what breaks the relationship between skill system and overall female labor force participation (last column in Table 1.2). Thus, the Scandinavian countries have high female participation rates despite having a male-dominated private sector. The reason is a large, and heavily feminized, public sector.

1.4.3. Social insurance and redistribution
Although the argument in this book emphasizes the insurance functions of the welfare state, the politics of insurance and redistribution are intimately related. To understand why this is the case it is first necessary to make a distinction between the \( \text{ex ante} \) and \( \text{ex post} \) distribution of income. The idea is closely related to Rawl’s notion of the veil of ignorance. Workers who are behind the veil do not know with certainty how they will fare in terms of future employment and income. In this situation, risk-averse people will demand insurance against loss of employment and income. Assuming that the time-inconsistency problem is overcome and insurance is provided, \( \text{when} \) the future arrives the \( \text{ex post} \) distribution of income will be more egalitarian than the \( \text{ex ante} \)
distribution. An implication of this logic is that in equilibrium, a generous tax and transfer system will result in redistribution even if the system is solely intended for social insurance purposes.

But the logic works from redistribution to insurance as well. If pressure for redistribution produces a more egalitarian after tax and transfer distribution of income, such redistribution will serve an insurance function so long as benefits are not based on ascriptive criteria such as race or ethnicity. This is important because while the provision of social insurance implies a time-inconsistency problem, redistribution does not. Institutions that promote redistribution, therefore, solve a social choice problem and explain why countries with highly redistributive policies often do much better in terms of economic performance than we would expect from neoclassical analyses of the welfare state that warn against the distortionary effects of redistribution. Chapter Four explores this interaction between redistribution, insurance and the economy in detail.

Here the basic idea can be illustrated with some data on pre- and post-tax and transfer income from the Luxembourg Income Study. The specific numbers are from John Stephen, Evelyn Huber, and associates’ calculations of pre-and post-tax and transfer income inequality for households, adjusted for family size (see Bradley et al. 2002 for details).\(^{16}\) The inequality measure is the gini coefficient, and redistribution is the percentage reduction in the gini from the pre-to post-tax and transfer distribution of income. To ensure that the measure is related to the concept of wage protection, the data only includes the working age population. The data are available for 14 advanced democracies and represent averages for a period starting in the late 1970s and ending in the mid 1990s (time coverage varies by country).

Figure 1.5 shows the reduction in pre- and post-tax and transfer inequality as a function of the level of taxes and transfers. As expected, there is a positive relationship (r=.68), and, although we do not know from this relationship how much is due to a deliberate attempt to produce

---

\(^{16}\) Pre-tax and transfer income is income from wages and salaries, self-employment income, property income, and private pension income. Post-tax and transfer income is disposable personal income, including all market income, social transfers, and taxes.
redistribution as opposed to insurance, Huber, Stephens and their associates have found a strong positive relationship between tax and transfers and redistribution after controlling for the partisan preferences of governments and a host of other factors (Bradley et al. 2002). In fact, their findings indicate that the level of taxes and transfers (what they term welfare state generosity) is one of the most important determinants of both redistribution and poverty reduction. But welfare

Figure 1.5. Redistribution as a function of taxes and transfers in 14 democracies.

Notes: Redistribution is the percentage reduction in the gini coefficient from pre-to post-tax and transfer for households with working-age adults. Taxes and transfers is total taxes as a percent of GDP plus total transfers as percent of GDP, after both measures have been standardized. Both measures were developed by Bradley et al (2002) based on LIS data and OECD national accounts data.
state generosity itself is left unexplained. My contention is that generosity is strongly affected by
the structure of skills and the demand for insurance to which they give rise.

The second step in the argument is, therefore, to relate skill structure to the level of taxes and
transfers. Again using vocational training rates as a rough indicator for national skill structure,
Figure 1.6 shows that skills are indeed closely related to the magnitude of tax and transfers
(r=.86) and indirectly to redistribution (r=.50). Despite the emphasis on insurance over

Figure 1.6. Taxes and transfers as a function of vocational training activity.

Sources: Same as in Table 1.1 and Figure 1.5.
distribution, skill structure is, thus, important for explaining not only pre-tax/transfer income equality as shown above) but also welfare state redistribution.

However, as argued above, causality runs in the opposite direction as well. That is to say, if investment in specific skills is a function of the availability of income insurance, redistribution via the tax and transfer system will tend to produce a skill profile that is more specific. Without redistributive insurance, investment in general skills is the best defense against adverse changes in the labor market. This brings us back to the power resources model. There is strong empirical evidence that countries which are dominated by left governments also redistribute more (Hibbs 1977; Korpi 1983; 1989; Bradley et al., forthcoming), and it is also widely argued that left governments reduce wage inequality (Boix 1998; Iversen and Wren 1998).

But why are some countries dominated by left governments while others are dominated by right governments? Although government partisanship is often assumed to be a reflection of the overall level of working class mobilization, Chapter Four argues that it is mainly determined by differences in coalitional dynamics as a result of differences in electoral systems. Table 1.3 shows the strong empirical relationship using a new data set on parties and legislatures assembled by Cusack and Engelhardt (2002) and Cusack and Fuchs (2002). The figures are the total number of years with right and left governments in 17 advanced democracies between 1945 and 1998, organized by type of electoral system. Mirroring a similar finding by Powell (2002), the two variables exhibit a strong association: among majoritarian systems, 75 percent of governments were center-right, whereas in PR systems 70 percent were center-left (excluding “pure” center governments). The numbers in parentheses convey a sense of the evidence at the level of countries, classifying countries according to whether they have an overweight (more than 50 percent) of center-left or center-right governments during the 1945-98 period.

The importance of the pattern revealed in Table 1.3 for the argument in this book is that the electoral system is, in fact, related to the production system. Peter Katzenstein (1985) pointed out this association many years ago by linking social corporatism to PR. More recently, Hall and
Soskice (2000) have argued that “coordinated market economies” are much more likely to have PR institutions than “liberal market economies.” Here the association is explained by the equilibrium relationship between electoral institutions, redistribution, insurance, and investment in specific skills. In terms of the argument of this book, if the government can credibly commit to redistributive spending, it serves as an insurance against the loss of income when specific skills are rendered obsolete by technological and other forms of change. The argument that will be spelled out in Chapter Four is that PR is a key commitment mechanism in political economies that depend on workers making heavy investments in highly specific skills.

Table 1.3. Electoral system and the number of years with left and right governments (1945-98)

<table>
<thead>
<tr>
<th>Electoral system</th>
<th>Government partisanship</th>
<th>Proportion of right governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportional</td>
<td>Left: 266 (8)</td>
<td>Right: 116 (1)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Majoritarian</td>
<td>Left: 86 (0)</td>
<td>Right: 256 (8)</td>
</tr>
</tbody>
</table>

*Note: Excludes centrist governments and PR cases with single party majority governments.*

1.5. *Adapting to change*

One of the most remarkable facts about the welfare state is that public spending did not vastly differ between the US, continental Europe, or Scandinavia in the early 1960s (Rothstein 1998; Esping-Andersen 1999). “In the 1960s,” according to Rothstein, “the difference between these countries in total public spending was much smaller [than today] – the level in the United States was about 28 percent compared to a mean of 29 percent for the Scandinavian countries”. This does not mean that basic differences in unemployment, employment, and wage protection through
labor market institutions did not exist at that time. They did, but the role of the state in the social insurance system through taxes and transfers was not terribly dissimilar.

The tremendous expansion of social spending since then, and the increased variation across countries, can be gleaned from Table 1.4. It shows total government spending as a percent of GDP across 15 OECD countries, the standard deviation of spending, the difference between the largest and smallest spender, and the difference in spending between Sweden and the US from 1960 to 1993. Note that spending roughly doubled in this period, from 17 percent in 1960 to 37 percent in 1993, but the variation in spending grew even faster. Thus, the standard deviation in spending increased by about 150 percent and the difference between the biggest and smallest spender by 170 percent. Comparing Sweden and the US, the difference in spending ballooned from 7 percent to 26 percent of GDP, a 260 percent increase in the same time period.

Table 1.4 Government spending and variation in spending across 15 OECD countries (1960-93)

<table>
<thead>
<tr>
<th>Year</th>
<th>Government spending as percent of GDP</th>
<th>Standard deviation of spending</th>
<th>Differences between highest and lowest spender</th>
<th>Difference between Swedish and US spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>17.3</td>
<td>3.3</td>
<td>11.4</td>
<td>7.3</td>
</tr>
<tr>
<td>1965</td>
<td>20.0</td>
<td>4.1</td>
<td>13.1</td>
<td>8.7</td>
</tr>
<tr>
<td>1970</td>
<td>23.3</td>
<td>5.3</td>
<td>19.2</td>
<td>11.1</td>
</tr>
<tr>
<td>1975</td>
<td>28.6</td>
<td>5.2</td>
<td>20.0</td>
<td>10.6</td>
</tr>
<tr>
<td>1980</td>
<td>30.7</td>
<td>6.6</td>
<td>24.0</td>
<td>19.7</td>
</tr>
<tr>
<td>1985</td>
<td>32.7</td>
<td>6.5</td>
<td>23.9</td>
<td>21.7</td>
</tr>
<tr>
<td>1990</td>
<td>32.5</td>
<td>6.6</td>
<td>25.4</td>
<td>22.0</td>
</tr>
<tr>
<td>1993</td>
<td>36.9</td>
<td>8.4</td>
<td>30.9</td>
<td>26.4</td>
</tr>
<tr>
<td></td>
<td>Ratio of 1993 level to 1960 level</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.1</td>
<td>2.5</td>
<td>2.7</td>
<td>3.6</td>
</tr>
</tbody>
</table>
What accounts for the rise in spending and the growing cross-national variation in spending? One prominent argument points to increased exposure to risks in the international economy as a result of economic globalization (Cameron 1978; Garrett 1998; Rodrik 1998). But there is, in fact, little empirical support for this thesis as I will show in Chapter Five. Instead, the rise in income protection coincides with the onset of deindustrialization — the secular drop in industrial employment starting in the early to mid 1960s — and the reason is closely related to the role of skills. Because deindustrialization represents a serious threat to those workers who have made significant investments in firm or industry specific skills — a threat that cannot easily be addressed within the “private” system of protection in the labor market – it is associated with a rise in electoral demands for public compensation and risk sharing. And although deindustrialization has occurred everywhere, its speed has varied considerably across countries. More importantly, the effects of deindustrialization have been mediated by the skill regime, as well as by the institutional capacity of the political system for credible commitment. Building on recent work on unemployment by Blanchard and Wolfers (2000) I demonstrate this institutional conditioning of common shocks with a variety of empirical tests in Chapter Five.

The growing electoral pressure for government spending has also provided politicians and political parties an opportunity to shape the structure of social protection according to ideological preferences. A particularly contentious partisan issue has concerned the extent to which the state should expand publicly provided services. Because high protection countries with extensive wage and employment regulation have created relatively few jobs in low-productivity services, and because this is where the potential for job growth (especially for women) is greatest, social democratic parties have favored an expansion of jobs in public services while Christian democratic parties have emphasized transfers and social services provided through the family. Liberal parties, by contrast, have advocated deregulation.

A critical issue examined in Chapter Six is the relationship between social protection, especially a relatively flat wage structure, and employment. Although high-protection countries have been very successful in international markets, belying the notion that high protection reduce
competitiveness, the have been poor employment performers in non-traded private services. At
the same time, good employment performers such as the US have paid a heavy price in the form
of greater inequality. The underlying problem, I argue, is that lack of international trade in
services, which has undermined the ability of countries to take advantage of their comparative
advantage. High protection countries, for example, have squeezed out low-skill jobs without an
offsetting expansion of high-skill jobs. I call the emerging response “selective and shielded
deregulation”, which means that greater flexibility in parts the labor market (especially for part-
time and temporary employment) is coupled with new tax and transfer policies to shield the
inequalizing consequences. I assess the limits and possibilities of this strategy and compare it to
the welfare reforms characterizing Anglo Saxon countries.

1.5. Outline of book.
The book is divided into two parts. The first part focuses on cross-national differences and
explores the micro-foundations of these differences. Chapter Two presents a comparative-
historical analysis that traces the rise of the postwar social protection system to compromises
between interests rooted in the industrial economy. It also provides much of the comparative data
that are used in this and subsequent chapters. Chapter Three develops an asset-based theory of the
sources of individual social policy preferences, while Chapter Four considers the translation of
these preferences into policies though the political system. The second part focuses on dynamic
aspects of the argument. Chapter Five explains the rise of the welfare state since the 1960s as a
politically mediated outcome of the shift from industry to services, while Chapter Six explores the
distributive and political consequences of this shift, as well as the recent reforms to which it has
given rise.