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Paetzold, J.; Vliet, O.P. van

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CONVERGENCE WITHOUT HARD CRITERIA:  
DOES EU SOFT LAW AFFECT DOMESTIC  
UNEMPLOYMENT PROTECTION  
SCHEMES?

JÖRG PAETZOLD AND OLAF VAN VLIET

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**WORKING PAPERS** IN  
**ECONOMICS AND FINANCE**

# Convergence without hard criteria: Does EU soft law affect domestic unemployment protection schemes?

Jörg Paetzold\* and Olaf van Vliet†

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## Abstract

The European Employment Strategy (EES) aims to promote convergence of domestic labour market policies by soft law instruments. Previous studies on the impact of the EES are mainly focused on active labour market policies. The present study aims at explaining cross national variation in national passive labour market policies and unemployment benefit levels. Building on the most recent measures and pooled time series data, the empirical findings reveal the presence of a convergence process among the most advanced economies regarding passive labour market policy efforts, with the EES fostering this trend even further. Furthermore, our findings support the argument that the EES creates pressure on governments to reform domestic labour market policies, but this pressure varies across countries and over time. The results suggest that the recommendations from the European Council have contributed to unemployment benefit reform processes.

*Keywords:* Passive labour market policies, convergence, European Employment Strategy, Europeanization, Open Method of Coordination, welfare state

*JEL codes:* H53, J68

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\*Salzburg Centre of European Union Studies, University of Salzburg, Mönchsberg 2, A-5020 Salzburg, Austria. E-mail: joerg.paetzold@sbg.ac.at

†Department of Economics, Leiden University, PO Box 9520, NL-2300 Leiden, The Netherlands. E-mail: o.p.van.vliet@law.leidenuniv.nl

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# 1 Introduction

Both convergence and Europeanization are two of the most debated issues in comparative welfare state analysis. Welfare state policy convergence across countries can be expected to result from confrontations with relatively similar economic, demographic and societal problem patterns. In the same vein, Europeanization is said to foster convergence tendencies, exposing different political jurisdictions to the same external pressure and ideas of political problem solving. In this paper, we address and disentangle both issues in the context of passive labour market policies, an area experiencing extensive policy reform efforts over the last decades. In the context of labour market policies, the European Employment Strategy (EES) is an important source of Europeanization. As an application of the Open Method of Coordination (OMC), the EES aims to promote convergence of labour market policies by soft law mechanisms like emulation and policy diffusion. Previous studies are mainly focused on the impact of the EES on domestic active labour market policies (Van Vliet and Koster 2011, Heidenreich and Zeitlin 2009, Armingeon 2007, Zeitlin and Pochet 2005, Mosher and Trubek 2003). On the contrary, less research focused on the impact of the EES on passive labour market policies like unemployment benefit schemes. This is remarkable, because the EES does not only aim at higher employment and lower unemployment levels by promoting active labour market policies. Another key message of the EES is that disincentives for labour market participation stemming from passive policies should be reduced (Vandenbroucke and Vleminckx 2011, Cantillon 2011). Moreover, many authors point at the potential constraining effect of promoting activation schemes on its programmatic counterpart, that are passive labour market measures (Heidenreich and Zeitlin 2009, De la Porte 2007, Büchs 2007, De la Porte and Pochet 2004). Put differently, the recalibration of labour market policies as proposed by the EES is argued to induce shifts of resources from passive to active measures and thereby exerts pressure on the generosity of passive schemes. The existing literature on the relationship between the EES and domestic reforms of passive labour market policies consists mainly of case study oriented research. For instance, it has been described how the EES has contributed to the German Hartz reforms (Büchs 2007, Heidenreich and Bischoff 2008). In this paper, we examine to what extent the evidence presented in the case studies can be generalized across countries and over time.

In the comparative political economy literature on welfare states, the convergence of passive labour market policies has been a subject of research for quite some time (Schmitt and Starke 2011, Caminada et al. 2010, Montanari et al. 2008, Korpi and Palme 2003, Cornelisse and Goudswaard 2002). Starting from the analyses of total public social expenditures at the aggregate level, many researchers progressed to

analysing social expenditures at the program level. However, none of the existing studies has explicitly been focused on the variation in expenditures on passive labour market policies. This is remarkable given the importance of unemployment benefit schemes in welfare states. Building on the approach proposed by Plümper and Schneider (2009), we aim to analyse the variation in passive labour market policy expenditures across 22 countries using several measures. In addition, the study relies on replacement rates as measure for the generosity of unemployment benefits.

To sum up, this paper seeks to make three contributions to the literature: First, we aim to extend existing studies on EES' impact on employment policies to the realm of passive labour market policies. Second, we seek to complement the welfare state literature by specifically focusing on passive labour market policy expenditures. Hence, we aim to extract the influence of the EES on both the convergence of and the variation in efforts devoted to PLMPs across countries and time. Third, relying on new data, this study updates the existing research on labour market policy to 2009 and includes the first years of the credit crisis at the beginning of the 21st century.

## **2 Passive labour market policies, the European Employment Strategy and convergence processes**

### **2.1 Passive labour market policies**

PLMPs are policies which entitle labour market participants to benefits in the case of unemployment. These passive measures encompass public support for income maintenance. As such, unemployment benefit schemes allow unemployed people to take the time to search for the best jobs. On the other hand passive measures can be expected to discourage people from taking up work. Yet, in the empirical literature it is fiercely debated which effect prevails (for a summary see Palme 2010). One strand of research argues that relatively generous benefits might prolong the duration of people staying in unemployment and thereby contribute to the burden of long-term unemployment (Layard et al. 2005). Others stress the role unemployment benefits play in preventing people from falling into poverty, point at positive effects from the so-called entitlement effect or highlight the fact that longer job searches may result in better matches on the labour market (Nickell et al. 2005, Belot and Van Ours 2004, Acemoglu and Shimer 1999). This is the background against which the policy guidelines of the EES on reforming PLMPs were drafted.

### **2.2 Europeanization and soft law**

Europeanization can be understood as the impact from various types of EU policies on national policy-making processes (Radaelli 2003/b). In the case of PLMPs, the

relevant vehicle to represent EU-level policy influence is the European Employment Strategy. Launched in 1997, the EES' main objective is to promote employability and adaptability of the European workforce. In the EES, the catch-word is coordination, defining common policy goals which are intended to guide national labour market policy-making. As an intergovernmental means of the EU, instruments of the EES are non-binding but consist of recommendations, guidelines and benchmarks. This makes the EES a multifaceted instrument, exerting different levels of influence on the member states. This characteristic makes the EES especially suitable for cross-country longitudinal comparisons, wielding an influence which does vary across countries and over time (Mosher and Trubek 2003).

The European Employment Strategy aims to promote active labour market policies while simultaneously emphasizing the perceived work disincentives of passive measures (Zeitlin and Trubek 2003, Savfati and Bonoli 2002). The different guidelines as laid out in the EES are permeated with a set of policy norms arguing in favour of a stronger focus on labour market participation (Heidenreich and Bischoff 2008). Especially the first of the four pillars (Employability) of the EES contains guidelines which endorse activation of the workforce. This paradigm of activation is frequently said to have a constraining effect on passive labour market schemes (Heidenreich and Zeitlin 2009, de la Porte 2007, Büchs 2007, de la Porte and Pochet 2004). In general, it is argued that when budget-constrained politicians reprioritize LMPs in favour of activation, passive schemes are likely of bearing the brunt of this reprioritization (Swank 2011). In particular, the EES itself enforces the idea of reforming PLMPs. It advocates the idea of 'make work pay' and advises individual member states to "examine in more detail disincentives within the tax and benefit system which may discourage labour-market participation of all groups [...]" (Council of the EU 2000). Indeed, case study literature indicates that EES contributed to rearrangements of LMPs on the expense of passive schemes (Van Gerven and Beckers 2009, Preunkert and Zirra 2009, Büchs 2007, Ballaster 2007). For instance Büchs (2007) points out that the Hartz IV act in Germany with its introduction of new means-tested benefit regulation while simultaneously fostering activation schemes was presented as the government's strategy to implement EES guidelines. In the same vein, a reform tightening the eligibility length of unemployment benefits in Spain (2002) is said to be accomplished partly under the influence of Council recommendations and EES guidelines (Ballaster 2005). Yet, it is an empirical question to what extent these country-specific factors and developments presented in the case-study literature can be generalized across countries and over time. Hence, we test the hypothesis that the EES has a negative effect on the generosity of passive labour market schemes.

### 2.3 Convergence and the European Employment Strategy

As Plümper and Schneider highlighted in their recent paper (2009), most convergence studies fall short in theoretically grounding the specific convergence process they expect. We aim to tackle this problem by specifying the underlying theoretical mechanisms of EES-induced convergence of PLMPs.

First of all, following Knill (2005: 768), we understand policy convergence as 'any increase in the similarity between one or more characteristics of a certain policy across a given set of political jurisdictions over a given period of time'. What is more, convergence induced by Europeanization requires that EU-level policy goals are passed on to national policy arenas. In general, there are three main channels through which EU-level policies might be transmitted into national policy-making (Montanari 2008): Harmonization through directives and regulations, indirect convergence via constraints on political decision-making and emulation by non-binding policy recommendations and intergovernmental means of governance like the EES. In the realm of labour market policies, emulation is a key driver of policy diffusion and convergence (Zeitlin et al. 2005). The existing literature derives three main effects on how the EES may shape domestic labour market policy reforms. First, the policy goals and guidelines presented in the European Employment Strategy are argued to have a normative influence on employment policy reforms of the participating countries (Jacobsson 2011). The performance of governments regarding these policy goals exert peer pressure on one another and result in changes of domestic policies. Being more precisely, the effectiveness of these goals relies on soft sanctions in the form of 'naming and shaming', assuming that no member state wants to be seen as a violator of norms. Büchs (2007) showed how parliamentary factions in the German Bundestag identified EES' benchmarking process as a catalyst of increased reform pressure on the national government. When more countries in the EU are pressured to reform according to the same standards, labour market policies become more similar. Second, the EES might influence national policy-making through the exchange of information and ideas leading to similar policy responses. Through the EES, member states continuously participate in mutual learning activities like peer review and 'best practices', resulting in cross-national policy diffusion (Mosher and Trubek 2003, Radaelli 2003/a, Ferrera et al. 2001). In this process, which can be conceptualized as mimicking and imitating, policy outcomes are expected to become more similar. For instance, an analysis of unemployment benefit reforms in four countries by Van Gerven and Beckers (2009) showed a match between the objectives laid out by the EES and the implemented policy of reforms. All four countries set their policy goals in line with EES recommendations, resulting in a convergence of reform agendas. Finally, Visser (2009) describes policy learning via the EES as a process of enforcing policy makers to change their attitudes from

passive administering of unemployment towards new methods of activation which in turn made EU Member States 'to move in the same direction, with different degrees of intensity and varying success' (Visser 2009). Third, the EES is sometimes strategically used by national actors for external legitimization of certain labour market policies. For instance, domestic governments are tempted to make use of the EES to justify unpopular measures or reforms (Mailand 2008). During the Hartz IV legislative procedure in Germany, the ruling government used various EES guidelines to argue for out-of-favour measures like the increased pressure put on unemployed for taking up jobs (Büchs 2007). Hence, national actors became advocates of EES goals and transmitted those into the national political arena.

In summary, the EES has been argued to play a significant role in promoting convergence of labour market policies of the member states. Indeed, the European Commission concluded in an assessment in 2002 that the EES "started a process of convergence between member states' employment policies towards prevention of long-term unemployment [...]" (European Commission 2002: 11-13). In order to test this commission statement we hypothesize that participation in the EES fosters convergence of passive labour market policies. From the lines of reasoning outlined above, we derive two main hypotheses to test:

*H1: The EES has a negative effect on the generosity of domestic passive labour market policy schemes*

*H2: Convergence of passive labour market policy schemes should be stronger among countries which participate in the EES than among other advanced industrialized democracies.*

The EES can be understood as a comprehensive instrument, exerting different levels of pressure on the member states. In particular, the scope and exposure to country-specific Council recommendations can differ quite significantly. When the Council issues a recommendation, the Council notifies a government that it should make more progress on a certain policy area. For instance, one of the recommendations that Germany received regarding PLMPs states that Germany 'should examine in more detail disincentives within the tax and benefit system which may discourage labour market participation of all groups[...]' (Council of the EU 2000). Some member states received a fair amount of recommendations calling for reforms, whereas other countries have not been subject of any of these advices (see Figure 1). It has been argued that the sheer number of recommendations a state receives does create important pressure



to domestic reform (Tucker 2003). Furthermore, Heidenreich and Bischoff (2008) highlight that the number of recommendations does matter due to the fact that this number represents the relative position of a country regarding the respective policy field. Thus, we disaggregate the EES into single Council recommendations on PLMP reforms and thereby test a third hypothesis:

*H3: The number of Council recommendations received by a country is negatively related to the generosity of domestic passive labour market policy schemes.*

### **3 Data, measures and method**

#### **3.1 Dependent variable**

An important issue of debate among welfare state scholars is the selection of indicators that should be used to test for convergence of 'welfare efforts' in general and of labour market policies in particular. This is known as the 'dependent variable problem' (Clasen and Siegel, 2007). On the one hand, there are authors advocating for aggregated measures like annual expenditure, highlighting the gains stemming from the macro perspective of those data (Starke and Schmitt 2011, Castles 2002, Swank 2002). On the other hand, researchers accuse aggregate measures of being too broad and sometimes misleading. Their claim is that aggregated data are potentially distorted by its denominator (GDP), the differences in tax treatments and cyclical trends. They prefer indicators such as replacement rates instead (Montanari 2007, Allan and Scruggs 2004, Korpi 2003). We aim to overcome that divide by applying the same empirical approach on both indicators, i.e. on unemployment replacement rates and on expenditures on unemployment benefits. The use of both measures provides a broad-based assessment of how Europeanization influences labour market policy outcomes.

The dependent variable of this study displays 'PLMP effort'. For PLMP expenditure data, we use information from the OECD Social Expenditure Database (2012). Expenditures on PLMPs consist mainly of expenditures on unemployment benefit schemes. First, we use government spending on passive measures as a percentage of the GDP. Second, we express PLMP expenditures relative to ALMP expenditures. ALMP expenditures consist of expenditures on employment services, training, employment incentives, integration of the disabled, direct job creation and start-up incentives. Furthermore, we employ two measures for the generosity of PLMPs at the individual level. First, PLMPs expenditures are measured per unemployed relative to

GDP per capita, yielding a fine-tuned measure frequently used in cross-country comparisons on employment policies (Armingeon 2007, Scarpetta 1996). Second, we include unemployment replacement rates. The net unemployment replacement rate is the ratio of the net income from unemployment benefits to the net income from work. The calculations assume a worker, aged 40, who earns the average production worker wage.<sup>1</sup> The measure indicates the generosity of unemployment benefits in the initial phase of unemployment. Data are taken from the Unemployment Replacement Rates Dataset (Van Vliet and Caminada 2012). In addition, also the duration of the entitlement rights would be a relevant measure of the generosity of unemployment benefits. However, this study does not include the duration because of the limited data availability. Earlier research shows that the average duration of unemployment benefits across OECD countries has decreased in the 1980s and the 1990s, but in most countries the changes are relative small (Swank 2011, Van Vliet 2010). The use of these four measures for PLMPs enables us to draw conclusions about both the absolute magnitude of passive labour market policies and its relative size.

### 3.2 Convergence and Europeanization variables

To identify simple beta-convergence, we include the lagged level of the dependent variable. Beyond that, our analysis focuses on Europeanization as a factor conditioning convergence in labour market policies. To assess whether and, if so, how Europeanization matters, we include a variable capturing the effect of the EES. It consists of a dummy variable scored 1 for EU countries participating in the EES from 1998 onwards. By using interaction terms revealing whether the EES exerts an impact on the rate of convergence, we further detangle its conditional effect (Plümper and Schneider 2009). Furthermore, this strategy helps us to control for the proposition that the observed convergence might be the mere result of similar challenges posed to welfare regimes across all countries.

Subsequently, we disaggregate the EES and enter single Council recommendations on passive schemes as a variable to our analysis. Following Van Vliet and Koster (2011) who constructed a measure for recommendations on ALMPs, our variable measures the number of Council recommendations calling for PLMP reforms received per country and per year. In the case of Council recommendations we rely

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<sup>1</sup>The OECD has made a fundamental change in the approach of the average wages. The classical approach of calculating the average wage was based on the average wage of a production worker (APW), which refers to the wage level in the manufacturing industry. The new concept for the average wage refers to the average worker wage (AW), which includes much more sectors. The differences in the levels of the APW and the AW can be significant for individual countries. The transition from APW to AW started in 2005 and the AW is available from 2000 onwards. The APW data is available for all years up to 2005 and for the year 2007. Hence, there is no consistent time series for the period 1985-2008. In order to have a consistent replacement rate time series, Van Vliet and Caminada(2012) estimated the APW for the years 2006 and 2008 based on the growth rate of the AW.

on our own data gathered by screening Council documents from 2000 to 2004. Due to the time-break of the EES in 2005, subsequent data concerning Council recommendations is not used in this study.<sup>2</sup> All recommendations and the corresponding country-specific challenges regarding benefit systems as named by the Council are listed in Appendix B.

### 3.3 Control variables

The control variables used in our study are customary in the literature. First of all, we include the unemployment rate measured as a percentage of civilian labour force to our analysis. In the short run, since soaring levels of unemployment increase the number of potential benefit recipients, PLMP spending is expected to rise. In the long run however, high expenditures on unemployed benefits due to persistently high levels of joblessness may lead to budgetary problems and hence, benefits will be made less generous (Gaston and Rajaguru 2008, Saint-Paul 1996). Therefore, we expect an immediate positive impact of unemployment on PLMP expenditure as well as a negative constraining effect over time. Second, excessive government debt and budgetary crises are considered as a potential driving force for cutbacks in passive unemployment schemes. Therefore, we include gross government debt as a percentage of GDP to control for the consequences of indebtedness. Acknowledging theoretical accounts of the efficiency and the compensation hypotheses and to capture the influence of globalization on convergence, we control for the effects of economic openness of a country (Jensen 2011, Rodrik 1998). We include two different measurements for openness, one for external trade dependence and a second one to capture financial interdependence. The first one is calculated from the sum of exports and imports divided by GDP whereas the latter consists of the net inflows of foreign direct investment (FDI) as a percentage of GDP. In general, more economically developed countries provide more generous unemployment compensation schemes and have higher spending on labour market policies. Therefore, we include the GDP of a country as a control variable for its overall economic development. Furthermore, we insert Huber's index of constitutional structures to control for the constraining effect of national veto players on cross-sectional convergence. It is commonly understood that a higher number of domestic veto players hampers radical changes and thus, constrains governments from big shifts in PLMP efforts (Starke 2006, Person 1996). According to power resource approaches, similar socio-economic challenges do not necessarily lead to convergence, since political mediation and the distribution of power act as an intervening variable (Korpi 2003). In addition, left parties are argued to differ significantly from other parties in their preferences for labour market policies in general

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<sup>2</sup>But see Copeland and ter Haar (forthcoming).

and for benefit levels in particular (Allan and Scruggs, 2004). To control for the role of domestic politics on changes in LMPs, we deploy the percentage of total cabinet posts held by leftist parties from the Comparative Political Data Set (Armingeon et al. 2008). Following Plümper and Schneider (2009), our study aims to estimate rather than to measure convergence by using pooled time-series cross-section regression analyses. Estimating rather than measuring convergence holds many advantages, for instance it gives the researcher the possibility to check for conditional convergence, to account for interaction effects and to test hypotheses (Plümper and Schneider 2009).

### 3.4 Method

The model of choice in our analysis is the error correction model (ECM), allowing us to test for short- as well as long-term effects of the explanatory variables on changes in the dependent variable simultaneously (Busemeyer 2009, Iversen and Cusack 2000). This is achieved by including both the level and first difference of all time-variant explanatory variables. Being more precisely, the level of a respective variable captures its long-term response, while the first difference measures the short-term response to a change of this variable. Virtually time-constant variables like constitutional veto points or the variables displaying EES-influence are entered in levels only. As the error correction model is useful for stationary and integrated data alike, it is suited to overcome problems of unit roots (De Boef and Keele 2008, Beck 1991). Furthermore, models relying exclusively on level variables are said to be prone to high levels of autocorrelation, whereas error correction models proved to tone down this effect (Podestà 2006). Since an ECM involves that the dependent as well as a number of the independent variables are measured as first differences, our model accounts for problems of stationarity and autocorrelation, two issues that often make time series cross-section regression difficult (Kittel and Winner 2005). Potentially remaining autocorrelation is addressed by estimating the models with an AR(1) disturbance term. In order to correct for panel heteroscedasticity and contemporaneous spatial correlation, we use panel-corrected standard errors (Beck and Katz 1995). Formally we can express our baseline model as follows:

$$\Delta y_{it} = \alpha + \beta y_{it-1} + \sum \gamma_j X_{it-1} + \sum \delta_j \Delta X_{it} + \theta y_{it-1} z_{it} + \mu z_{it} + \omega_t + \varepsilon_{it} \quad (1)$$

where  $\Delta y_{it}$  stands for the change of the dependent variable in country  $i$  from one period to the next. The lagged variable  $y_{it-1}$  is the convergence indicator and  $y_{it-1} z_{it}$  reflects the interaction term indicating whether the rate of convergence depends on constraint  $z$  (i.e. on EES participation). If  $\beta = 0$  and  $\theta \neq 0$ , then the speed of convergence entirely depends on the constraint  $z$ . If  $\beta, \theta \neq 0$ , the convergence is caused

partly by EES and partly by some other unobserved factors. If, finally,  $\beta \neq 0$  and  $\theta = 0$ , participation in EES has no significant effect on the convergence of PLMPs.  $X$  stands for a vector of the independent variables discussed above,  $\alpha$  is the intercept and  $\varepsilon$  the error term.  $\Delta X_{it}$  represents short-term effects of changes in explanatory variables and are captured by  $\delta$ . Long-term effects of the levels ( $X_{it-1}$ ) are calculated by  $\gamma_j/\beta$ . Finally, time effects  $\omega_t$  are included capturing common trends and external shocks all countries are jointly exposed to.

Since the inclusion of both a lagged dependent variable and country fixed effects renders the estimator inconsistent (Nickell 1991), fixed effects are not included in the model. Furthermore, since the ECM involves first differencing and removes the unit specific effects, fixed effects are not required to receive consistent estimations (Wooldridge 2002). This enables us to include (virtually) time-invariant variables without causing wrong inferences, a problem empirical researchers are frequently faced with when using fixed effects (Baltagi 2001). However, including country dummies to our model we received similar results.<sup>3</sup>

Passive labour market policies in general as well as replacement rates in particular are said to change quite slowly over time, making it sometimes difficult to detect changes on annual basis. Therefore, as an additional step in our empirical analysis, 3-year averages are used to make changes in our social indicators more pronounced and hence, easier to detect potential effects. What is more, this procedure helps us to relax assumptions about the adequate lag length of the explanatory variables, a potential issue when political data is used (Van Vliet and Koster 2011, Armingeon 2007). With regard to political variables like the EES or Council recommendations, it is unlikely that their influence on PLMPs necessarily occurs with a one year time lag. It seems more plausible that the influence of the EES takes a longer period until its influence on PLMPs materializes. Using period data accounts for this sluggishness and is quite common in welfare state analysis, either as a check of robustness (Armingeon 2007) or as a genuine approach in itself, best known through the SCIP dataset (Korpi 2003).

The study includes 22 OECD countries. This group consists of 15 EU countries - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom and 7 non-EU countries, namely Australia, Canada, Japan, New Zealand, Norway, Switzerland and the United States. The group of non-EU countries is included to control for any international trend of reprioritization of labour market policies other than Europeanization. The period included runs from 1985 to 2009, which enables us to compare the period before the introduction of the EES in 1997 with the period after its introduction.<sup>4</sup>

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<sup>3</sup>Results are available upon request.

<sup>4</sup>The OECD Social Expenditure Database contains data until 2007 and projections for the later years.

## 4 Descriptive statistics

Table 1 presents measures of the generosity of passive labour market policies in 22 OECD countries. Between 1985 and 2009, the average level of expenditures on PLMPs as a percentage of GDP has remained fairly unchanged across the EU and the other OECD countries. In 2009, the EU-15 countries spent on average 1.4 percent of GDP on PLMPs against 0.7 percent in the non-EU countries. Relative to the expenditures on activation policies, PLMP expenditures have on average decreased across the EU-15 countries, but they have increased across the OECD-7 countries. The average PLMP expenditures per unemployed and the average net unemployment replacement rates have decreased as well across the 22 OECD countries. Indeed, PLMP expenditures and replacement rates have decreased in the majority of the countries. Interestingly, both at the beginning and at the end of the period unemployment benefit schemes were more generous in the EU-countries than in the non-EU countries. Furthermore, there is considerable variation in the PLMPs across the countries. In Luxembourg, an unemployed average production worker received a benefit of 83.5 percent of the last earned income in 2009, while in the United Kingdom this was 17.3 percent.

The dispersion measures indicate that PLMP expenditures as a percentage of GDP have converged across all 22 OECD countries. Relatively to ALMP expenditures, PLMP expenditures have converged across the EU-15 countries, but they have diverged across the OECD-7 countries. The same is true with regard to unemployment replacement rates, where the EU-15 countries have converged again over the whole time span, whereas the OECD-7 countries show signs of divergence. The same holds for PLMP expenditure per unemployed, which indicates a trend of convergence for the EU-15 countries but no change in the dispersion across the OECD-7 countries. However, for the last two policy measures the changes in the coefficient of variation are rather small. This indicates that the more substantial changes in the standard deviation are mainly driven by the changes in the mean levels.

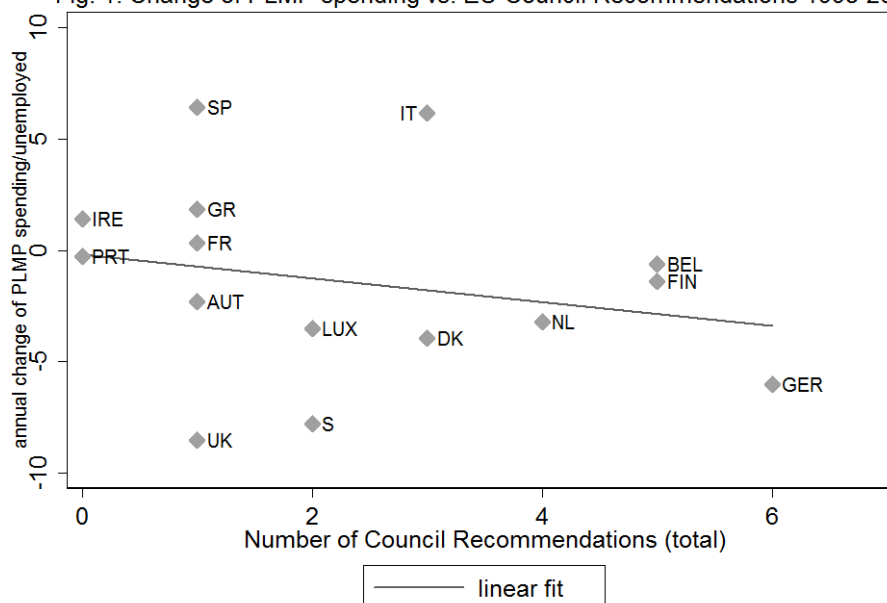
With respect to the third hypothesis, Figure 1 displays the relationship between the overall number of Council recommendations a country received and its mean annual change in PLMP expenditure per unemployed after the launch of the EES in 1998. The total number of recommendations calling for PLMP reform ranges from zero for Ireland and Portugal to a maximum of six recommendations received by Germany, reflecting the varying degree of exposure in terms of EES targeting. Taking a closer look, the scatter plot suggests that especially the Continental but also the Nordic welfare states have been subject of policy recommendations regarding passive labour market schemes. This seems rather counterintuitive, as the Nordic countries are usually considered as the best pupils of the class when it comes to welfare state

Table 1: Passive labour market policy indicators (OECD-22)

	Passive LMP expenditure as percentage of GDP			Passive LMP expenditure relative to ALMP expenditure			Passive LMP expenditure per unemployed relative to GDP			Net unemployment re- placement rate		
	1985	2009	Change	1985	2009	Change	1985	2009	Change	1985	2009	Change
Australia	1.2	0.6	-0.6	3.4	1.7	-1.7	20.6	12.8	-7.9	27.0	22.5	-4.5
Austria	0.9	1.3	0.4	3.7	1.8	-2.0	38.3	36.1	-2.2	58.0	55.0	-3.0
Belgium	1.9	1.6	-0.2	2.8	1.7	-1.1	24.3	30.3	6.0	71.2	58.9	-12.3
Canada	1.8	1.0	-0.9	3.0	2.8	-0.2	23.9	15.2	-8.7	65.8	58.6	-7.1
Denmark	3.0	1.3	-1.7	4.6	1.1	-3.5	66.1	26.2	-39.9	73.6	55.3	-18.3
Finland	0.9	1.5	0.6	1.8	2.0	0.2	22.0	23.6	1.6	64.2	53.6	-10.6
France	1.1	1.4	0.3	2.5	1.5	-1.0	17.9	22.1	4.3	71.4	69.4	-2.0
Germany	1.3	1.5	0.2	2.8	1.5	-1.3	26.7	24.8	-1.9	63.0	60.0	-3.0
Greece	0.3	0.7	0.4	2.1	2.0	-0.1	6.7	11.9	5.2	33.5	38.8	5.3
Ireland	3.4	2.6	-0.8	3.2	3.0	-0.2	31.9	29.1	-2.8	49.1	36.5	-12.6
Italy	0.5	1.3	0.8	3.6	3.1	-0.5	7.6	25.9	18.3	2.4	63.1	60.7
Japan	0.3	0.4	0.1	0.9	0.9	0.0	20.4	10.2	-10.2	57.8	60.5	2.7
Luxembourg	0.2	0.7	0.5	2.0	1.8	-0.2	23.6	16.5	-7.0	88.5	83.5	-4.9
Netherlands	3.3	1.7	-1.6	2.5	1.4	-1.1	51.3	62.1	10.8	85.7	68.3	-17.4
New Zealand	0.6	0.5	-0.1	0.7	0.7	0.0	22.5	9.5	-13.0	35.8	23.4	-12.4
Norway	0.5	0.5	0.0	0.8	0.7	-0.1	24.1	19.8	-4.3	66.6	66.6	0.0
Portugal	0.4	1.2	0.8	1.9	1.7	-0.2	6.6	16.2	9.7	78.1	77.7	-0.3
Spain	2.9	2.9	0.1	8.8	3.5	-5.4	23.6	22.1	-1.46	76.6	48.8	-27.7
Sweden	0.8	0.7	-0.1	0.4	0.6	0.2	29.0	10.7	-18.3	80.8	59.8	-20.9
Switzerland	0.3	1.0	0.7	1.4	-	-	38.3	27.4	-10.9	73.0	70.8	-2.2
United Kingdom	1.5	0.3	-1.2	2.2	1.0	-1.2	17.7	5.5	-12.2	25.2	17.3	-7.9
United States	0.5	1.0	0.5	2.1	6.1	4.0	10.9	15.1	4.3	63.7	57.2	-6.5
Mean OECD-22	1.2	1.2	-0.1	2.5	2.1	-0.5	24.2	21.5	-2.7	59.6	54.8	-4.8
Standard deviation	1.0	0.7	-0.3	1.8	1.3	-0.5	10.9	12.0	1.2	22.1	17.5	-4.6
Coefficient of Variation	0.8	0.6	-0.2	0.7	0.6	-0.1	0.4	0.6	0.1	0.4	0.3	-0.1
Mean EU-15	1.4	1.4	-0.1	2.8	1.8	-1.0	24.6	24.2	-0.4	61.4	56.4	-5.0
Standard deviation	1.1	0.7	-0.4	2.0	0.8	-1.1	12.0	13.3	1.3	24.3	16.6	-7.7
Coefficient of Variation	0.8	0.5	-0.3	0.7	0.5	-0.2	0.5	0.5	0.1	0.4	0.3	-0.1
Mean OECD-7	0.8	0.7	-0.1	1.9	2.9	1.0	23.4	15.7	-7.7	55.7	51.4	-4.3
Standard deviation	0.6	0.3	-0.3	1.1	2.3	1.2	8.8	6.2	-2.6	17.4	20.0	2.6
Coefficient of Variation	0.7	0.4	-0.3	0.6	0.8	0.2	0.4	0.4	0.0	0.3	0.4	0.1

Note: For the expenditure measures, the values for Denmark, Italy and Japan are around 1985. For passive LMP expenditure relative to ALMP expenditure, the values for Greece, New Zealand and Norway are around 2009.

Fig. 1: Change of PLMP spending vs. EU-Council Recommendations 1998-2007



matters. However, because the PLMPs are fairly generous in Continental and Nordic countries, they contain relatively strong disincentives for work. Therefore, Sweden, for instance, has been recommended to review tax and benefit systems to improve job incentives (see also Jacobsson 2005).<sup>5</sup> What is more, Figure 1 shows a fair amount of variation in growth of PLMP spending per unemployed, with the Southern countries having the biggest increases during the period of examination. The average annual growth rate for the group of Southern countries (IT, GRE, PRT, SP) sums up to 3.5

In summary, the descriptive statistics indicate that the expenditures on PLMPs have decreased and that unemployment benefits have become less generous. These changes are in line with the guidelines of the EES which state that the disincentives of benefit schemes should be reduced in order to promote employment and to reduce unemployment. The shift in financial resources from passive to active policies is also in line with the guidelines of the EES. Furthermore, the generosity levels of PLMPs seem to have converged, which is in line with the expected impact of the EES as well. However, based on the descriptive statistics, it is not clear whether the convergence trend is significantly stronger across the EU-15 than across the 22 OECD countries. Regression analyses should shed more light on this question.

<sup>5</sup>In contrast, Southern countries receive less recommendations on PLMPs, as they have less generous PLMPs, but they receive more recommendations regarding activation policies than Nordic countries.



## 5 Regression results

The results of the regressions are presented in Table 2. First and foremost, in all models the coefficient for the lagged dependent variable (LDV) is negative and shows high significance for all four labour market policy indicators. This result indicates that convergence in passive labour market policies is a phenomenon observable across the board of the industrialized world. What is more, the results suggest that convergence is fostered by EES participation. The interaction terms between EES membership and the LDVs show mostly negative signs. As laid out in our second hypothesis, this indicates that countries participating in the EES converge faster than non-participants. This can be illustrated in the model of PLMP expenditure as a percentage of GDP, where the effect of the LDV changes from -0.051 for non-participating countries to -0.124 for EES countries.<sup>6</sup> Looking at 3-year averaged data, we obtain similar but more pronounced results with a greater statistical significance of the interaction term. As 3-year averages make changes in the dependent variable more pronounced, the EES bolsters the speed of convergence significantly in the models of PLMP as a percentage of GDP, PLMP relative to ALMP and PLMP per unemployed. Only in the case of unemployment replacement rates as the indicator of interest, a significant effect of EES on the speed of convergence cannot be found. Overall, the results are in line with our second hypothesis that EES bolstered the convergence of passive labour market policy schemes.

Testing for our first hypothesis, results are less intuitive as expected. Countries subject to EES tend to increase spending on PLMPs more than their non-EES counterparts, even though results in some cases miss the level of significance.<sup>7</sup> This brings doubts about the constraining effect of the EES on passive labour market policies. However, this result seems partly driven by the Southern EU member states which experienced substantial growth of public expenditure in general (see Starke et al. 2008) and strong increases of PLMP expenditure in particular at that period of time (see Appendix Figure A1). On average, this catching up development potentially dominates the constraining effect stemming from the EES. To test this assumption, we ran auxiliary regressions and changed our overall EES dummy to one comprising only the Northern member states (EU-15 minus Greece, Italy, Portugal, Spain). This time, the EES-North dummy has the expected negative sign for all four of our indicators and is significant in most cases, which gives further evidence for a distinct development in PLMP efforts among the Southern countries (see table A1 of the Appendix). These results point to the comprehensive nature of the EES, pursuing different objectives in regard to changes of labour market policies among its member

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<sup>6</sup>The effect of EES participation is given by  $-0.051 + (-0.073) = -0.124$ .

<sup>7</sup>This result holds also for excluding the interaction term (not reported).

Table 2: EES Impact on UNRR & PLMP expenditures, 1985-2009

Variable	Annual data				3-year average data			
	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW
LDV	-0.0512** (0.0228)	-0.1688*** (0.0300)	-0.0634** (0.0263)	-0.0358*** (0.0078)	-0.0914** (0.0426)	-0.4130*** (0.0435)	-0.0692* (0.0364)	-0.0860*** (0.0167)
EES	0.1371*** (0.0345)	0.1386 (0.1739)	0.0124 (0.0097)	0.0072 (0.0070)	0.3235*** (0.0608)	0.2652 (0.2161)	0.0440*** (0.0117)	0.0266* (0.0136)
EES*LDV	-0.0729** (0.0326)	-0.0804 (0.0896)	-0.0212 (0.0433)	-0.0048 (0.0109)	-0.1735*** (0.0448)	-0.2387*** (0.0890)	-0.0987* (0.0546)	-0.0236 (0.0208)
$\Delta$ Unemployment	0.0966*** (0.0096)	0.1692*** (0.0252)	-0.0192*** (0.0023)	-0.0022** (0.0109)	0.1487*** (0.0188)	0.1886*** (0.0274)	-0.0047* (0.0027)	-0.0035*** (0.0014)
Unemployment <sub>t-1</sub>	0.0006 (0.0042)	-0.0003 (0.0066)	-0.0014** (0.0006)	-0.0010*** (0.0001)	0.0090 (0.0132)	0.0336*** (0.0127)	-0.0031*** (0.0010)	-0.0032*** (0.0005)
$\Delta$ Left cabinet portfolios	-0.0004 (0.0003)	-0.0005 (0.0010)	0.0000 (0.0001)	-0.0000 (0.0000)	-0.0008 (0.0008)	0.0011 (0.0010)	0.0001 (0.0001)	0.0001 (0.0001)
Left cabinet portfolios <sub>t-1</sub>	-0.0004* (0.0003)	0.0011 (0.0010)	0.0000 (0.0001)	0.0000 (0.0000)	-0.0016** (0.0007)	-0.0001 (0.0001)	0.0000 (0.0001)	0.0001 (0.0001)
$\Delta$ GDP growth	-0.0189*** (0.0047)	-0.0035 (0.0171)	-0.0029*** (0.0009)	-0.0014*** (0.0005)	-0.0289* (0.0148)	0.0000 (0.0243)	-0.0032 (0.0034)	-0.0016 (0.0014)
GDP growth <sub>t-1</sub>	-0.0331*** (0.0062)	0.0261 (0.0226)	-0.0058*** (0.0014)	-0.0021*** (0.0006)	-0.0348 (0.0250)	0.1210*** (0.0352)	-0.0044 (0.0056)	-0.0048** (0.0021)
$\Delta$ Debt	0.0026 (0.0016)	0.0059 (0.0066)	0.0006 (0.0004)	-0.0001 (0.0002)	-0.0028 (0.0032)	0.0059 (0.0049)	-0.0005 (0.0007)	-0.0000 (0.0003)
Debt <sub>t-1</sub>	-0.0005** (0.0002)	-0.0002 (0.0009)	-0.0000 (0.0001)	0.0001** (0.0000)	-0.0012* (0.0007)	0.0005 (0.0015)	0.0001 (0.0002)	0.0002*** (0.0001)
$\Delta$ Trade	-0.0022 (0.0014)	0.0003 (0.0046)	-0.0008*** (0.0003)	0.0002 (0.0001)	0.0011 (0.0032)	0.0006 (0.0072)	-0.0008 (0.0008)	-0.0000 (0.0003)
Trade <sub>t-1</sub>	0.0007** (0.0003)	0.0024*** (0.0009)	0.0002** (0.0001)	-0.0000* (0.0000)	0.0005 (0.0007)	0.0019 (0.0015)	0.0003* (0.0002)	-0.0001 (0.0001)
$\Delta$ FDI	-0.0002 (0.0002)	0.0001 (0.0012)	-0.0001** (0.0000)	0.0000** (0.0000)	-0.0005 (0.0005)	0.0036** (0.0018)	-0.0000 (0.0001)	0.0001* (0.0001)
FDI <sub>t-1</sub>	-0.0005** (0.0002)	-0.0021*** (0.0007)	-0.0001** (0.0001)	0.0001*** (0.0000)	-0.0010** (0.0005)	-0.0018 (0.0012)	-0.0001 (0.0001)	0.0002*** (0.0001)
Veto points	0.0023 (0.0031)	0.0215 (0.0174)	0.0003 (0.0011)	0.0001 (0.0003)	0.0024 (0.0100)	0.0458* (0.0245)	0.0028 (0.0024)	0.0020* (0.0012)
Countries	22	22	22	22	22	22	22	22
Adj. R <sup>2</sup>	0.63	0.32	0.24	0.16	0.75	0.56	0.33	0.27
Observations	491	478	491	491	165	163	163	168

Panel corrected standard errors in parentheses. All models are estimated with autoregressive disturbances.

\*\*\*Significant at 1%, \*\*Significant at 5%, \*Significant at 10%.

states. Aiming to filter the differentiated effect the EES had on single member states, this result leads us directly to the application of an even more fine-grained measure of EES' influence, namely using individual country specific recommendations regarding PLMP reform. This approach takes into account the different levels of exposure to EES recommendations countries experienced. As already highlighted in the descriptive section, some countries received a fairly high number of recommendations concerning passive labour market reforms, whereas others did not receive any advice. According to Tucker (2003), the bare number of recommendations does matter in influencing member states policy reforms. Hence, to test for our third hypothesis, we disaggregate the EES influence into Council recommendations on PLMP reform.

Table 3 presents results obtained from our analysis focussing on variation within the EU. Again, convergence can be observed across all countries and measures for the dependent variable. In all models, the variable indicating Council recommendations has a negative sign although the effects do not reach significance in all cases. Nevertheless, given the low statistical power, effects close to conventional significance levels can be considered meaningful. It gives weak support to the expectation that the Council is able to influence LMP reforms through its policy recommendations. Especially looking at the averaged data brings some evidence to this third hypothesis, revealing a negative covariation between the number of Council recommendations and changes in passive labour market policies. It should be noted that the use of Council recommendations may potentially identify reversed causality, with countries having lower levels of PLMP efforts receiving lesser recommendations. However, this reversed effect could perhaps be expected with variables measured in levels, but it is less likely when looking at period changes. Therefore, the use of first differences of the dependent variables diminishes this potentially distorting effect. Moreover, since the inclusion of a LDV on the right-hand side controls for the differences in levels, our model predicts the effect of an additional recommendation when levels are hold constant (= *ceteris paribus* condition ).

Interestingly, in comparison to annual data the results obtained from 3-year periods mostly indicate significant effects of the EES variable, its interaction term and the Council recommendations, respectively. This underpins our reasoning for using averaged data as it takes into account that new policies may need time to be implemented. Nevertheless, overall results are at times mixed and of feeble magnitude, indicating at most a weak systematic relationship between the EES and domestic reforms of passive labour market policies.

A brief look at the control variables shows that most variables have the expected signs. For instance, a change in the unemployment rate has a positive significant effect on both PLMP spending as a percentage of GDP and PLMP relative to ALMP spending. This is what one would expect, since higher unemployment rates

Table 3: Impact of Council recommendations on UNRR & PLMP expenditures, 1985-2009

Variable	Annual data				3-year average data			
	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW
LDV	-0.0687** (0.0282)	-0.2076** (0.0528)	-0.0630** (0.0237)	-0.0440** (0.0082)	-0.1339* (0.0784)	-0.4662*** (0.1182)	-0.0996** (0.0463)	-0.1204*** (0.0177)
Council Recommendations $_{t-1}$	-0.0131 (0.0377)	-0.0769 (0.1048)	-0.0019 (0.0067)	-0.0055# (0.0036)	-0.0543 (0.0645)	-0.1247# (0.0789)	-0.0287*** (0.0080)	-0.0078** (0.0038)
$\Delta$ Unemployment	0.0954*** (0.0111)	0.1300*** (0.0369)	-0.0178*** (0.0022)	-0.0028 (0.0018)	0.1560*** (0.0246)	0.1295*** (0.0421)	-0.0076** (0.0035)	-0.0049*** (0.0016)
Unemployment $_{t-1}$	-0.0012 (0.0063)	0.0100 (0.0088)	-0.0025*** (0.0008)	-0.0015*** (0.0004)	0.0004 (0.0194)	0.0382* (0.0199)	-0.0043*** (0.0016)	-0.0043*** (0.0010)
$\Delta$ Left cabinet portfolios	-0.0004 (0.0005)	-0.0009 (0.0017)	0.0000 (0.0001)	-0.0000 (0.0001)	-0.0003 (0.0010)	0.0036 (0.0026)	0.0003* (0.0002)	0.0001 (0.0001)
Left cabinet portfolios $_{t-1}$	-0.0005 (0.0004)	0.0023* (0.0013)	0.0000 (0.0001)	0.0000 (0.0000)	-0.0015* (0.0008)	0.0052* (0.0030)	0.0002 (0.0002)	0.0001 (0.0001)
$\Delta$ GDP growth	-0.0151** (0.0061)	-0.0082 (0.0216)	-0.0026** (0.0011)	-0.0009 (0.0007)	0.0079 (0.0286)	-0.0751 (0.0460)	-0.0012 (0.0040)	-0.0005 (0.0018)
GDP growth $_{t-1}$	-0.0359*** (0.0084)	0.0211 (0.0261)	-0.0054*** (0.0016)	-0.0019** (0.0008)	0.0017 (0.0450)	-0.0085 (0.0533)	-0.0020 (0.0058)	-0.0058** (0.0029)
$\Delta$ Debt	0.0054* (0.0027)	0.0047 (0.0086)	0.0010** (0.0005)	-0.0000 (0.0003)	0.0005 (0.0057)	0.0025 (0.0097)	-0.0001 (0.0008)	0.0001 (0.0004)
Debt $_{t-1}$	0.0002 (0.0005)	-0.0016 (0.0014)	0.0001 (0.0001)	0.0001 (0.0001)	0.0004 (0.0017)	-0.0011 (0.0022)	0.0003 (0.0003)	0.0002** (0.0001)
$\Delta$ Trade	-0.0020 (0.0016)	-0.0007 (0.0054)	-0.0010*** (0.0003)	0.0002 (0.0002)	0.0033 (0.0041)	0.0105 (0.0095)	-0.0004 (0.0008)	-0.0001 (0.0004)
Trade $_{t-1}$	0.0008** (0.0004)	0.0035*** (0.0011)	0.0002* (0.0001)	-0.0001*** (0.0000)	0.0000 (0.0014)	0.0042** (0.0017)	0.0002 (0.0002)	-0.0002* (0.0001)
$\Delta$ FDI	-0.0001 (0.0002)	-0.0003 (0.0013)	-0.0000 (0.0000)	0.0000* (0.0000)	-0.0002 (0.0006)	0.0020 (0.0026)	-0.0000 (0.0001)	0.0001* (0.0001)
FDI $_{t-1}$	-0.0003 (0.0002)	-0.0029*** (0.0009)	-0.0000 (0.0000)	0.0001*** (0.0000)	-0.0005 (0.0007)	-0.0036* (0.0022)	-0.0000 (0.0001)	0.0002*** (0.0001)
Veto points	0.0051 (0.0098)	-0.0210 (0.0253)	0.0018 (0.0022)	0.0015** (0.0006)	0.0478* (0.0273)	-0.0256 (0.0314)	0.0109** (0.0048)	0.0056*** (0.0020)
Countries	EU-15	EU-15	EU-15	EU-15	EU-15	EU-15	EU-15	EU-15
Adj. R <sup>2</sup>	0.66	0.37	0.29	0.23	0.76	0.62	0.41	0.38
Observations	341	339	341	341	115	115	115	118

Panel corrected standard errors in parentheses. All models are estimated with autoregressive disturbances.  
 \*\*\*Significant at 1%, \*\*Significant at 5%, \*Significant at 10%, #Significant at 12.5%.

are almost immediately transmitted into higher spending for unemployment benefits through the automatic stabilizers. On the contrary, a change in unemployment has a robust negative impact on PLMP expenditures per unemployed. Given that a higher number of unemployed people immediately increases the denominator of this specific indicator, this result is no surprise. What is more, hikes in the unemployment rate as well as persistently high levels of joblessness seem to put pressure on the generosity of unemployment replacement rates. As expected, real GDP growth is negatively associated with most of our labour market indicators, reflecting changes in the denominator. Running against our expectations the number of constitutional veto points is positively associated in most of our models, but the level of significance is low. For the other control variables, the estimations show no clear results.

## **6 Conclusion**

Convergence of national labour market policies is an important goal of the EES. Existing studies on the effect of the EES have been mainly focused on activation policies, while less attention has been paid to PLMPs. With respect to PLMPs, the underlying goal of the EES is to reduce work disincentives. In our analysis, we showed that affluent democracies became more similar with regard to PLMP efforts, with the EES fostering this trend even further. Moreover, we examined to what extent the findings on the relationship between the EES and reforms of PLMPs presented in the case study literature can be generalized to a larger sample of countries. The results suggest that via Council recommendations the EES has contributed to reforms which resulted in lower expenditures on passive labour market policies. In line with this finding, analyses of replacement rates suggest that unemployment benefit schemes have become less generous. However, we have to acknowledge the individualized effect of the EES on single member states, mirrored by the rejection of our hypothesis claiming a negative effect of the EES as a whole. The pressure to domestic policy reforms stemming from the EES varies across countries and time.

With regard to the Council recommendations, our results suggest that there is a negative covariation between the number of Council recommendations and spending on passive labour market policy measures, especially when 3-years averaged data are used. This relationship is visible in both descriptive illustrations as well as in the overall negative effect of Council recommendations in our empirical analysis. Hence, these findings tend to support the argument that Council recommendations create pressure on governments to reform domestic PLMPs (Tucker 2003, Heidenreich and Bischoff 2008). Interestingly, this result is not in line with the results of Van Vliet and Koster (2011) which indicate that Council recommendations do not contribute to domestic policy reforms in the case of activation policies. A tentative

explanation for the different results might be related to the differences in the type of domestic policy reforms. Reductions in the generosity of unemployment benefit schemes are less popular reforms than expanding activation programmes (Vis 2009). Therefore, domestic politicians use Council recommendations more for justifying cuts in unemployment benefits than for increasing public expenditures on activation schemes (Büchs 2007). As a result, recommendations are more relevant for PLMP reforms than for ALMP reforms.

Finally, the results indicate that the converging trend of public expenditure and unemployment benefits has progressed further across advanced industrialized countries and time. These findings are in line with earlier studies (Caminada et al. 2010; Starke et al. 2008). It is striking that convergence also materializes in the realm of unemployment replacement rates when controlled for a wide range of effects, rejecting the idea of on-going divergence and path dependency put forward by some authors (e.g. Montanari 2008, Korpi 2003). Although this study includes the first years of the credit crisis at the beginning of the 21st century, it is future research that should denote whether the crisis has triggered different policy responses by governments, or whether the trend of convergence continues.

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# Appendix

## A Growth of PLMP expenditure per unemployed in Southern member states

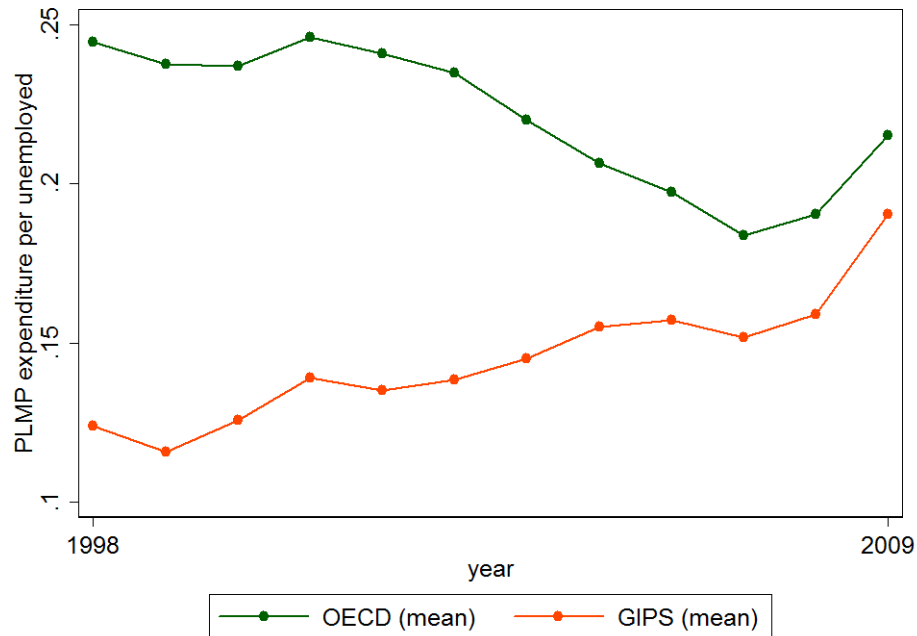


Figure A. 1: PLMP expenditure per unemployed in Southern member states, 1998-2009.

Table A. 1: EES Impact on UNRR & PLMP expenditures, by region (1985-2009)

Variable	Annual data				3-year average data			
	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW	$\Delta$ PLMP as % of GDP	$\Delta$ PLMP relative to ALMP	$\Delta$ PLMP per unemployed	$\Delta$ UNRR as % of APWW
LDV	-0.0665*** (0.0224)	-0.1989*** (0.0335)	-0.0689*** (0.0227)	-0.0386*** (0.0066)	-0.1346*** (0.0477)	-0.4411*** (0.0528)	-0.1060** (0.0511)	-0.0974*** (0.0145)
EES-North	-0.0278 (0.0245)	-0.3046*** (0.0839)	0.0005 (0.0081)	-0.0035* (0.0020)	-0.1649*** (0.0622)	-0.3226** (0.1568)	-0.0121 (0.0083)	-0.0162*** (0.0047)
$\Delta$ Unemployment	0.0979*** (0.0095)	0.1580*** (0.0241)	-0.0192*** (0.0022)	-0.0024** (0.0010)	0.1561*** (0.0184)	0.1845*** (0.0289)	-0.0045 (0.0028)	-0.0039*** (0.0012)
Unemployment <sub>t-1</sub>	0.0025 (0.0044)	0.0019 (0.0067)	-0.0012** (0.0006)	-0.0009*** (0.0001)	0.0148 (0.0141)	0.0241* (0.0137)	-0.0021* (0.0012)	-0.0031*** (0.0005)
$\Delta$ Left cabinet portfolios	-0.0004 (0.0003)	-0.0004 (0.0010)	0.0000 (0.0001)	-0.0000 (0.0000)	-0.0004 (0.0007)	0.0015 (0.0011)	0.0002 (0.0001)	0.0001 (0.0001)
Left cabinet portfolios <sub>t-1</sub>	-0.0003 (0.0002)	0.0014* (0.0008)	0.0001 (0.0001)	0.0000 (0.0000)	-0.0010* (0.0006)	0.0007 (0.0013)	0.0001 (0.0001)	0.0001* (0.0001)
$\Delta$ GDP growth	-0.0190*** (0.0048)	-0.0134 (0.0159)	-0.0030*** (0.0009)	-0.0015*** (0.0005)	-0.0291* (0.0156)	-0.0080 (0.0247)	-0.0031 (0.0029)	-0.0024* (0.0014)
GDP growth <sub>t-1</sub>	-0.0326*** (0.0064)	0.0092 (0.0201)	-0.0058*** (0.0014)	-0.0022*** (0.0006)	-0.0356 (0.0253)	0.1103*** (0.0297)	-0.0037 (0.0052)	-0.0054*** (0.0021)
$\Delta$ Debt	0.0030* (0.0017)	0.0051 (0.0063)	0.0006 (0.0004)	-0.0001 (0.0002)	-0.0026 (0.0032)	0.0065 (0.0046)	-0.0003 (0.0006)	-0.0001 (0.0003)
Debt <sub>t-1</sub>	-0.0003 (0.0002)	-0.0010 (0.0009)	-0.0000 (0.0001)	0.0000 (0.0000)	-0.0010* (0.0006)	-0.0001 (0.0017)	0.0001 (0.0002)	0.0002*** (0.0001)
$\Delta$ Trade	-0.0022 (0.0014)	0.0012 (0.0046)	-0.0008*** (0.0003)	0.0002 (0.0001)	0.0012 (0.0029)	0.0044 (0.0070)	-0.0009 (0.0008)	0.0001 (0.0003)
Trade <sub>t-1</sub>	0.0010*** (0.0003)	0.0037*** (0.0010)	0.0002** (0.0001)	-0.0000 (0.0000)	0.0016** (0.0007)	0.0033** (0.0015)	0.0004** (0.0002)	-0.0000 (0.0001)
$\Delta$ FDI	-0.0002 (0.0002)	-0.0003 (0.0011)	-0.0001* (0.0000)	0.0000* (0.0000)	-0.0003 (0.0005)	0.0016 (0.0017)	-0.0001 (0.0001)	0.0001** (0.0000)
FDI <sub>t-1</sub>	-0.0004* (0.0002)	-0.0025*** (0.0007)	-0.0001* (0.0001)	0.0000*** (0.0000)	-0.0009* (0.0005)	-0.0032*** (0.0012)	-0.0001 (0.0001)	0.0002*** (0.0000)
Veto points	-0.0005 (0.0034)	0.0247 (0.0196)	0.0001 (0.0011)	-0.0003 (0.0003)	-0.0076 (0.0100)	0.0553*** (0.0221)	0.0020 (0.0026)	0.0006 (0.0010)
Countries	22	22	22	22	22	22	22	22
Adj. R <sup>2</sup>	0.62	0.34	0.24	0.17	0.75	0.55	0.31	0.29
Observations	491	478	491	491	165	163	163	168

Panel corrected standard errors in parentheses. All models are estimated with autoregressive disturbances.  
 \*\*\*Significant at 1%, \*\*Significant at 5%, \*Significant at 10%.

## **B EU-Council recommendations listed by country and year**

### **Austria (1 recommendation in total)**

2002

*"Austria should therefore develop policies to ensure an adequate labour supply in the future. In this context, Austria should pursue and extend the reform of tax and benefit systems to increase the participation of older workers and low skilled and low paid workers [...]."*

### **Belgium (5 recommendations in total)**

2000

*"Belgium should therefore examine in more detail disincentives within the tax and benefit system which may discourage labour market participation, particularly of women and older workers."*

2001

*"Belgium should therefore continue examine disincentives within the tax and benefit system which may discourage labour market participation, particularly those affecting older workers"*

2002

*"Belgium should, in particular, examine the impact of recent measures and consider further measures aimed at preventing the early withdrawal of workers from work, as well as incentives enhancing the capacity of older workers to remain at work;"*

2003

*"Making work pay: Belgium should therefore implement the planned multiannual reduction of the tax and non-tax burden on labour so as to encourage employees to take up work and employers to create new jobs, in combination with a further review of the benefit system in order to remove unemployment traps;"*

2004

*"[...]Belgium should give immediate priority to review tax and benefit systems to remove subsisting unemployment traps and provide adequate incentives for active job search by reviewing the conditionality of benefits,"*

### **Denmark (3 recommendations in total)**

2000

*"Denmark should pursue reforms of the tax and benefit system so as to reduce the overall fiscal pressure on labour; in particular the tax burden on low incomes, and to increase incentives to take up or remain in jobs."*

2001

*"Denmark should therefore increase incentives to take up, or remain in, employment and continue to monitor closely reform of early retirement and leave schemes in the light of the need to increase labour supply;"*

2004

*"Denmark should give immediate priority to review tax and benefit systems to reduce marginal tax rates and raise incentives for low-income groups to work, including the unemployed and the inactive,"*

**Finland (3 recommendations in total)**

2001

*"Finland should therefore continue to review existing tax and benefit schemes, in order to increase incentives to work and to recruit workers, [...]"*

2002

*"Finland should therefore continue to review tax and benefit schemes with a view to encouraging participation in the labour market and ensuring the availability of labour; [...] and to improve incentives in benefit schemes, especially pensions, for people to take up work and to stay in the labour force;"*

2004

*"Finland should give immediate priority to further reform tax and benefit systems to remove unemployment traps;"*

**France (1 recommendation in total)**

2002

*"France should therefore building on recent tax-benefit reforms, continue implementing and monitoring the impact of policy measures designed to encourage workers to seek and remain in work, [...]"*

**Germany (6 recommendations in total)**

2000

*"Germany should examine in more detail disincentives within the tax and benefit system which may discourage labour-market participation of all groups, especially of older workers."*

2001

*"Germany should therefore continue to examine obstacles and disincentives liable to discourage labour market participation amongst all groups, especially older workers."*

2002

*"Germany should therefore continue to remove obstacles and disincentives liable to discourage labour market participation amongst older workers and other groups at risk; [...]"*

*"Germany should therefore pursue efforts to reduce taxes and social security contributions at the lowest end of the wage scale to make work pay and to enhance viable and acceptable employment prospects; examine and report on the impact of measures undertaken;"*

2003

*"Making work pay: Germany should therefore continue the reform of the tax and social benefit system, thereby ensuring sufficient incentives to take up work. At the same time, enforce the legal obligation of active job search as a condition for receipt of benefits."*

2004

*"Germany should give immediate priority to continue reform of the tax and social benefit system, thereby ensuring sufficient incentives to take up work; [...]"*

### **Greece (1 recommendation in total)**

2000

*"Greece should examine in more detail disincentives within the tax and benefit system which may discourage labour market participation, in particular of women, [...]"*

### **Italy (3 recommendations in total)**

2000

*"Italy should continue the implementation of the reform of pension and other benefit systems in order to reduce the outflow from the labour market into pensions and other schemes; [...]"*

2001

*"Italy should therefore continue the implementation of the reform of pension through the review planned for 2001 and review other benefit systems in order to reduce the outflow from the labour market [...]"*

2002

*"Italy should therefore continue to increase labour market flexibility with a view to better combining security with greater adaptability to facilitate access to employment; pursue the implementation of the reform of the pensions system through the review planned for 2001, and undertake the planned review of other benefit systems in order to reduce the outflow from the labour market; [...]"*

### **Luxembourg (2 recommendations in total)**

2000

*"Luxembourg should examine in more detail the tax-benefit system with a view to removing disincentives which may discourage the participation in employment, in particular of older workers; [...]"*

2001

*"Luxembourg should therefore pursue efforts and implement measures aimed at increasing labour-market participation rates amongst older workers and women, including a review of tax and benefit systems; [...]"*



**Netherlands (4 recommendations in total)**

2000

*"The Netherlands should continue efforts to improve the tax-benefit system with a view to removing disincentives which may discourage participation in employment, in particular of women and older workers. Resolute efforts are needed to reduce the high number of persons who remain outside the labour market supported by passive income support schemes;"*

2001

*"The Netherlands should therefore continue to cooperate with the social partners, to reduce disincentives in the benefit system liable to discourage people from participating in the open labour market, [...]"*

2002

*"The Netherlands should therefore in order to tap all possibilities of potential labour supply and reduce inactivity, address the cumulation of benefits, including local cost of living subsidies for low income recipients. [...]"*

2003

*"Making work pay: The Netherlands should therefore improve the transparency of the benefit system by an increased use of tax-based measures instead of subsidies and by a better coordination of national and local income support. Ensure that the disability scheme addresses both the need to contain the inflow into the scheme and to activate those who already receive benefits. [...]"*

**Spain (1 recommendation in total)**

2001

*"Spain should therefore examine the incentives/disincentives emerging from the tax and benefit systems with a view to increase participation in the labour market and stable employment."*

**Sweden (3 recommendations in total)**

2002

*"Sweden should therefore pursue reforms, including the setting of targets taking into account the national situation, to reduce the tax burden on labour in particular for low wage earners; pursue further the reforms of tax and benefit systems to promote work incentives;"*

2003

*"Making work pay: Sweden should therefore pursue the reforms of tax and benefit systems to improve work incentives, in particular for those groups for which the interplay between taxes and benefits has the most negative impact upon labour supply, [...]"*

2004

*"In view of the ageing population, there will be a need to sustain labour supply by exploiting potential sources of labour among immigrants, the young and the long-term sick, and by improving incentives to work."*

**United Kingdom (1 recommendation in total)**

2004

*"The United Kingdom should give immediate priority to ensure that active labour market policies and benefit systems prevent de-skilling and promote quality in work, by improving incentives to work and supporting the sustainable integration and progress in the labour market of inactive and unemployed people; [...]"*

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