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## **Determinants of Social Expenditure in Liberal Democracies: The Post World War II Experience**

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21. NRC-*Handelsblad*, September 8, 1994: "De immigratiestromen zullen dus niet te groot mogen worden (ook al vanwege de overbevolking van ons minilandje) en we zullen de immigranten met zorg en liefde het democratische spel en de bijbehorende publieke moraal moeten leren." (Translation HvG)

22. Justice Jackson in West Virginia state board of education versus Barnette, 319 U.S. 624 (1943).

23. That common codes or meanings should be a condition of communication is refuted by Dan Sperber and Deirdre Wilson, *Relevance: communication and cognition*, Oxford: Blackwell, 1986, p.15-21. I found extensive coverage of this matter by Nicholas Rescher. I quote his conclusion: "Consensus is not a criterion of truth is not a standard of value is not an index of moral or ethical appropriateness is not a requisite for cooperation is not a communal imperative for a just social order is not, in and of itself, an appropriate ideal. All in all, our position is a markedly guarded one that downgrades consensus both as a theoretical standard and as a practical requisite. Consensus – so we have seen – is no more than one positive factor that has to be weighed on the scale along with many others. Seen in this light, consensus can be viewed as an inherently limited good much like money. It has the character of being something one would welcome having if it can be secured – in the right way – by fair means and 'at the right price'." (Nicholas Rescher, *Pluralism: against the demand for consensus*, Oxford: Clarendon Press, 1993, p.199).

24. See van Gunsteren, H. *Organising plurality: citizenship in post 1989 democracies*, manuscript, Leiden, forthcoming.

25. John Searle, *The construction of social reality*, London: Penguin, 1995, p.8.

## Determinants of Social Expenditure in Liberal Democracies: The Post World War II Experience

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### Abstract

This article focuses on the major determinants of the amount of, and the change in Gross Domestic Product (GDP) apportioned to social expenditure in 18 liberal democracies in the period from the early 1960s to the 1990s. Using multivariate pooled time-series analysis, the article demonstrates that the principal predictors of social expenditure shares are the incumbent political parties, political institutions (above all counter-majoritarian arrangements), regime effects, and socio-economic conditions. Analysis within the context of a dissimilar-cases-design is consistent with these findings.

### 1 Introduction

This article centres on political and socio-economic determinants of social expenditure in liberal democracies from the 1960s until the 1990s. It thus covers a longer period than analysed to date in the literature.<sup>1</sup> The article explores not only determinants of expansionary social policy, but also determinants of social policy retrenchment (cf. Pierson 1996). Following the Schumpeterian approach to the study of the tax state, expenditure data are examined in order to explore the "machinery" of public policy (Schumpeter 1976: 332). The theoretical interest lies in establishing the major political and socio-economic determinants of the variation in social spending in democratic nations. Within this context, attention will focus particularly on the parties-do-matter-hypothesis (cf. Schmidt 1996) and on political-institutional theories, as recent cross-national studies have suggested that these are of major importance. To what extent do partisan factors, such as the partisan composition of governments, and political-institutional variables, such as a democratic constitution and state structures, or "constitutional structures" (e.g. Huber and Stephens 1993), contribute to a better understanding of the level of, and the change in social spending? To what extent do these variables really matter, when one controls for the effect of key variables from alternative explanations,<sup>2</sup> such as socio-economic theories on the one hand and incrementalism on the other, statistical problems of pooled timeseries,<sup>3</sup> and the impact of a most-similar-cases-design?<sup>4</sup>

The findings reported in this article are derived from a wide variety of sources on the historical development and the cross-national variation of social policy mainly in OECD member countries.<sup>5</sup> The dependent variable, i.e. public social spending as a percentage of GDP, is based mainly on OECD data on social policy expenditure from 1960 to 1981 and from 1980/81 to 1992.<sup>6</sup>

## 2 Determinants of social spending in liberal democracies in the post World War II period

In contrast to a widely shared view, the proportion of GDP allocated to social policy in OECD member countries over the last four decades has not been marked by convergence. Continuity or divergence have in fact been the dominant pattern. While the amount of GDP apportioned to social expenditure increased in all OECD member countries in the second half of the 20th century, the difference in levels of social spending that existed between these countries in the early 1950s, for example, was not reduced in the following decades. Consider the maximum and minimum in social spending-GDP ratios as shown by the ILO data on social security. According to the ILO data, the difference between the highest and lowest levels of social expenditure in 1950 was 11.3 percentage points, with Germany as the leader (14.8%) and Japan as the laggard in social spending (3.5%). Four decades later the gap between leaders and laggards with respect to social spending had widened even further. Japan's social spending share reached the 11.8% mark in 1989, a level equivalent to one third of Sweden's share of social expenditure in the same year (35.9%). The OECD data on social expenditure reveals similar patterns. According to the OECD sources, social spending as a percentage of GDP has increased in all industrial democracies, albeit at a pace which varies enormously from country to country. The result has been continuous diversity, as the wide range of variation between the high spenders in 1992 (Sweden [37.1%]) and Finland [34.8%]) and the welfare state laggards, such as Japan (12.4%) and the US (15.6%), demonstrates (see table 1).

What then accounts for the trends and the variation in the percentage of GDP spent on social policy in the OECD countries in the post World War II period, above all in the period 1960-92, for which comparable OECD data is available? And to what extent are the allocations to social spending determined by the key variables of the various approaches to the comparative study of the welfare state? Variables such as incumbent parties and political-institutional conditions, as the parties-do-matter-theory and political institutionalism suggest, or the distribution of power among classes and socio-economic conditions, as suggested by work on power resources and the socio-economic school of public policy analysis?<sup>7</sup>

Table 1 Social expenditure as a percentage of GDP in liberal democracies, 1950-92

Country	1950	1989	1960	1980a	1980b	1992
	ILO	ILO	OECD	OECD	OECD	OECD
Australia	4.7	7.8	7.71	12.4	11.7	16.4
Austria	12.4	24.8	16.47	22.5	22.3	24.7
Belgium	11.6	26.4	14.46	29.7	25.6	27.0
Canada	6.2	18.0	8.63	16.8	13.3	19.8
Denmark	7.9	28.4	12.40	24.7	27.6	29.9
Finland	7.4	21.4	7.96	19.6	18.9	34.8
France	11.5	27.1	14.34	23.3	23.5	27.3
FR Germany	14.8	22.7	17.51	24.8	25.0	27.3
Ireland	7.2	18.9	8.98	17.7	19.4	20.4
Italy	8.4	23.4	13.32	20.4	18.2	24.7
Japan	3.5	11.8	4.68	9.8	11.1	12.4
Netherlands	8.0	28.5	11.31	27.2	28.7	29.8
New Zealand	9.7	20.1	10.72	14.8	18.2	22.5
Norway	6.2	21.2	7.88	20.9	18.9	29.5
Sweden	9.7	35.9	10.29	27.7	30.4	37.1
Switzerland	5.9	14.4	4.98	14.1	14.1	20.6
United Kingdom	10.0	17.3	9.81	17.5	18.3	22.8
USA	4.0	12.2	7.13	14.8	12.4	15.6
Arithmetic Mean	8.28	21.13	10.48	19.9	19.9	24.6

### Source

OECD 1985, 1996, ILO inquiries in the cost of social security (various issues, including ILO 1996).

### Notes to table 1

Column 1: OECD member countries with democratic regime throughout the period under investigation.

Column 2: Social expenditure (International Labour Office (ILO) definition) as a percentage of national income in 1950.

Column 3: Social expenditure as a percentage of GDP 1989 (ILO 1996). Belgium: 1986.

Column 4: Social expenditure as a percentage of GDP 1960 (OECD 1985, education excluded). Belgium: 1964. Denmark: estimate based on transfer payments (% GDP).

Column 5: Social expenditure as a percentage of GDP 1980 (OECD 1985, education excluded). Denmark: 1979.

Column 6: Social expenditure as a percentage of GDP 1980 (OECD 1996).

Column 7: Social expenditure as a percentage of GDP 1992 (OECD 1996).

The hypothesis one can derive from these various approaches will be tested in the light of four critical questions:

1. To what extent are the various key variables, such as incumbent parties and political institutions, significant predictors in multivariate explanatory

- models, controlling for the principal variables of alternative schools of thought in comparative social policy analysis?<sup>8</sup>
2. Are the various approaches to the study of social spending, such as the parties-do-matter-theory and the institutions-do-matter-theory, really compatible with the data, when the estimation of the coefficients takes account of auto correlation, hetero skedasticity and contemporaneous correlation in the cross-time-cross-section data?
  3. Do the various key variables make a difference when incrementalism and the impact of policy inheritance are taken into account?
  4. Do the various hypotheses pass the test not only in the context of a most-similar-cases-design, but also in that of a most-dissimilar-cases research design?

The answers to these questions will be based on aggregate data pertaining to the structure and the determinants of a wide variety of social protection schemes.<sup>9</sup> Like the latest generation of cross-national comparisons of social policy such as Hicks and Swank (1992) and Janowski and Hicks (1994), this study bases its comparison of democracies on pooled time-series analysis.<sup>10</sup> The potential advantage of this type of analysis is obvious: pooled time-series promises to solve the problem of small sample restrictions in conventional comparisons where an imbalance exists between too many explanatory variables and too few cases. Within the context of a small *N* sample, the total number of potentially explanatory variables exceeds the degrees of freedom required for statistically modelling the relationship between the dependent and the independent variables. Thanks to pooled time-series, research strategies exist which get around that bottleneck. Within a pooled time-series in cross-national research, the cases are country-years, starting from country A in year 1, then country A in year 2 through to country Z in the last year of the period under investigation. This allows us to test the impact of a larger number of predictors of the level of and change in the dependent variable within the framework of a multivariate analysis.

### 3 Determinants of social expenditure (1960-92)

#### 3.1 Determinants of social expenditure-GDP ratios

To what extent do the key variables of the various approaches to comparative social policy contribute to the explanation of social expenditure-GDP ratios? According to the results of pooled time-series-analysis of the level of and change in social spending, all schools of thought mentioned above do have something to contribute.<sup>11</sup> However, the effects of three classes of variables are particularly consistent and powerful:

1. indicators of the political character of governments;
2. political-institutional structures and policy inheritance;
3. economic and socio-demographic factors (see tables 2 and 3).

Table 2 shows details of the major determinants of the level of social spending (as a percentage of GDP) in the 1960-92 period. The underlying model of table 2 focuses on the deep-seated institutional and socio-economic differences of the variation in social expenditure shares. The model premises that levels of social spending at a specific point in time *t* are the long-term and short-term product of underlying political and socio-economic causes, such as the long-standing distribution of power between leftist, centre, liberal, and conservative parties; the level of the rate of unemployment; and the needs and political demands of the elderly. Furthermore, these causes are regarded as input. It is also assumed that the input will be transformed (through a process which needs to be disentangled in more detailed historical studies) into output, such as the social expenditure to GDP ratio. Moreover, the model rests upon the view that the large differences in social expenditure-GDP ratios between nations at time *t*, though statistically dependent on expenditure at *t-1*, are in substantive terms mainly to be explained by politics, socio-economic conditions, and other non-expenditure predictors. The underlying model of table 2 emphasizes the political and socio-economic "construction" of policy outputs and outcomes, while policy inheritance, inertia or incrementalism are largely ignored at this stage of the analysis.<sup>12</sup>

In substantive terms, the findings shown in table 2 indicate the central importance of variables from partisan theory, institutionalism, and socio-economic schools of public policy analysis. According to the model in table 2, a high share of social spending, for example, is largely due to the following constellation of forces.<sup>13</sup>

1. A high rate of unemployment, which is consistent with the prediction that economic recessions provoke counter-cyclical interventions of unemployment benefit.
2. A large proportion of the population is elderly,<sup>14</sup> which supports the view that the joint impact of demography and social rights of the elderly greatly influence expenditure trends.
3. The age of democracy,<sup>15</sup> which is compatible with Tocqueville's argument that the trend towards rising public expenditure in a democracy rests mainly upon four factors: the strong demand for public goods on the part of the poor; the desire of the incumbent parties to buy political support through spending; the permanent strive for costly innovations; and maladministration as well as inefficiency due to frequent changes in power (de Tocqueville, 1981: 298-301).
4. Consistent with the parties-do-matter-hypothesis, leftist parties increase social spending, as do centre parties of Christian democratic character.

And despite their preferences for the market, Liberal parties in office are also part of the pro-welfare statist machinery. This is presumably largely due to the costs of compromise-seeking within the coalition with a pro-welfare state party, in which the liberal parties in most European countries were typically involved.<sup>16</sup>

5. Furthermore, coalition governments, in general, have also been conducive to rising social expenditure, presumably due to the higher costs of consensus formation in multi-party governments, in which at least one party had a major interest in gaining or maintaining support from the clientele of the welfare state.<sup>17</sup> In contrast to this, a single party government is, other things being equal, an inhibitor of social expenditure.
6. Counter-majoritarian institutions are a further major determinant of spending on social programmes.<sup>18</sup> Weak counter-majoritarianism widens the room to manoeuvre available to the government, while powerful counter-majoritarian arrangements can be used as effective veto points for opponents of welfare statism, as readers of *The Federalist Papers* and related work on the impact of counter-majoritarian institutions would predict.
7. Last but not least, high social spending levels are attributable to open economies,<sup>19</sup> which is consistent with Cameron's (1978) model of the growth of the public economy as a precondition of, and a response to, an open economy.

To focus on the opposite of what has been pointed out above, under which circumstances will the social budget then be relatively small? According to the model in table 2, a small budget in social policy is largely the outcome of the joint effect of a low rate of unemployment, a relatively young population, a young democracy, secular conservative parties in office, a single party government, strong counter-majoritarian institutions, and a low degree of openness of the economy.

The model in table 2 explains 80% of the variation in the dependent variable. All coefficients are highly significant and pass the required diagnostic statistics of heteroskedasticity, autocorrelation and contemporaneous correlation. Moreover, the results are robust.<sup>20</sup> The model suggests that socio-economic variables (such as the unemployment rate and the proportion of elderly), partisan factors and political institutional conditions are principal determinants of social spending. International interdependence also plays a role, albeit a less important one. Thus, according to the model in table 1, central variables from socio-economic schools of public policy research together with key indicators of partisan theory, neo-institutionalism and, though less consistent, a linkage between international and national factors offer the key for explaining the level of social expenditure in democratic OECD nations in the post-war period!

Table 2 Determinants of social spending (% GDP) in 18 democracies, 1960-92 (pooled time-series analysis, OLS-PCSE)

Independent variable	Unstandardized	Significance level
	regression coefficient	Significance level (a)
Rate of unemployment (% civilian labour force)	.427	.000
Old aged population (% > 65)	1.626	.000
Openness of the economy (import + export % GDP)	.012	.011
Age of democracy	.061	.000
Leftist party in office (% cabinet seats)	.016	.000
Centre party in office (% cabinet seats)	.038	.000
Liberal Parties in office (% cabinet seats)	.038	.000
Single governing party (= 1) or coalition (= 0)	-2.269	.000
Counter-majoritarianism-index (Schmidt-Index (Schmidt 1996) minus EU-score)	-.802	.000
Constant	-6.783	.000
R <sup>2</sup> (adjusted): 0.801; N = 594 (1960-92)		

Cases: OECD democracies in each year of 1960-92 period.

(a) Estimates are ordinary least squares estimates with panel corrected standard errors (Beck and Katz 1995). Two-step generalized least squares (FGLS) with correction for groupwise heteroskedasticity, contemporaneous correlation, and group specific autocorrelation fully support the model in table 2 (Kmenta 1990).

The model behind the coefficients in table 2 also explains in more detail why the social expenditure share differs from country to country. Take the Swedish case, for example. Spending on the welfare state in Sweden exceeded the 35% mark. This can largely be attributed to the fact that a high proportion of the population is age 65 and above; to a high degree of openness of the economy; a long history of leftist parties in office; an old democracy; and weak counter-majoritarian institutions.

Why is social spending in the US so moderate? The principal reasons include a relatively young population; moderate unemployment rates; the absence of a leftist party; the strength of republican governments; the low degree of openness of the American economy; and powerful counter-majoritarian institutions as major inhibitors of state activity.

And why is Germany's *Sozialstaat* positioned in the middle between the Nordic welfare state and liberal social policy arrangements? This position results from divergent tendencies. The fact that Germany's social policy is pushed towards a comprehensive welfare state is largely caused by a high proportion of the population being aged 65 and above; an open economy; the rate of unemployment; and the existence of two powerful *Sozialstaatsparteien*, one religious, the Christian Democratic Party, the other leftist and

secular, the Social Democratic Party, as well as the costs of compromise-seeking in coalition governments. These coalitions include the Liberals, who have rhetorically opposed and – hesitatingly – tolerated the construction of a powerful *Sozialstaat*. Other factors pull in a different direction: powerful counter-majoritarian institutions, such as federalism, an autonomous central bank and rather limited manoeuvrability for fiscal policy, and thus veto-points for opponents of the welfare state, are major impediments for a more expansive role of government in social spending in Germany.

The explanation given does not fit all cases equally well, as an inspection of the residuals from the regression equation derived from table 2 suggests. For example, Finland's dramatic economic decline of the early 1990s and the subsequent upward shift in social spending is too unique to be fully accounted for by the model in table 2. Analysis of the residuals also shows that Germany's social expenditure share from 1961 to the 1982 change in power was "too high" – relative to the trend throughout the OECD democracies in the period under investigation – but followed the trend thereafter. The big turnabout of 1982 from the Socialdemocratic-Liberal coalition to the Christian Democratic-Liberal government, the *Wende* as it has been labelled by proponents and opponents alike, consolidated the social policy apparatus at the level of the mid-1970s until the late 1980s, whereas German unification and the post-unification period resulted in an increasing social expenditure-GDP ratio. In contrast to this, the UK has been characterized throughout the period of investigation by a low social expenditure-GDP ratio, relative to the trend in the OECD area as a whole, whereas the share of social spending in the Netherlands consistently exceeded the predicted share from the mid-1960s until the early 1980s. So, too, did social spending in Sweden from the late 1980s until 1992.

### 3.2 What determines changes in social expenditure?

So far attention has focused on levels of social spending. This needs to be complemented by the analysis of changes in social expenditure. The latter analysis can answer questions such as: what facilitates the expansion of social policy, or, alternatively, the retrenchment of social policy programmes? To what extent does social policy respond to major changes in its environment, such as a dramatic increase in the proportion of the elderly? And to what extent does the social policy machinery lend itself not only to expansionary, but also to decremental policy?

Within the context of a quantitative comparison across time and space, there are two basic research avenues for studying these questions. One consists of measuring changes in social expenditure ratios (as a percentage of

GDP) against the past, for example against the previous year,<sup>21</sup> and using this measure as the dependent variable. The alternative procedure adds a lagged dependent variable as a measure of policy inheritance (Rose and Davies 1994) to the right hand side of the regression equation in table 2 and models the autocorrelation between the unlagged and the lagged variable. The latter strategy is adopted here. There are two major reasons for this choice. One concerns the policy inheritance argument. On the assumption that the room to manoeuvre for the incumbent party or parties at the point in time  $t$  is small and is largely conditioned by policy choices in the past, it is reasonable to add a policy inheritance variable to the explanation of policy outputs and outcomes at time  $t$ . A good indicator of policy inheritance is precisely the lagged dependent variable, i.e. the expenditure-GDP ratio at timepoint  $t-1$ . The other argument in favour of the chosen research strategy is related to our interest in testing the impact of parties and institutions (and other variables) as seriously as possible. When parties and institutions, for example, should prove to be significant predictors after controlling for policy inheritance, they can safely be regarded as relevant determinants of policy-making.

A lagged dependent variable in a time-series regression on political-economic data tends to account for most of the variation explained by alternative independent variables in a model without a lagged dependent variable. Social spending in democracies is no exception to this rule. Social spending at  $t-1$  is by far the best predictor of social expenditure-GDP ratios one year later, as table 3 demonstrates. This is consistent with theories of policy inheritance and theories of incremental policy change. Not unexpectedly, some of the long-term predictors of social spending levels in table 2 prove to be insignificant when short-term changes in social spending patterns must be explained. An example is the age of democracy variable which is insignificant in this context. Not surprisingly, two indicators of change not modelled in table 2 – economic growth and change in the rate of unemployment – are significantly associated with annual changes in social expenditure: the lower (higher) the rate of economic growth and the larger the increase (decrease) in the rate of unemployment compared with the previous year, the larger the increase (decrease) in the social expenditure-GDP ratio. This is also fully consistent with standard expectations.

However, the most interesting finding of table 3 concerns the robustness of the partisan composition variable, the counter-majoritarianism index and the old-aged indicator, which mirror the impact of social rights and the political relevance of the elderly. These determinants are significant predictors of changes in social spending, even if policy inheritance, business cycle, and demography are used to explain as much as possible (see table 3).<sup>22</sup>

Table 3 Level and change in social expenditure-GDP ratio in 18 democracies, 1961/60-1992/91 (pooled time-series regression)

Independent variable	Unstandardized regression coefficient	Significance level
Social spending % GDP in previous year	.957	.000
Real growth of GDP against previous year	-.083	.000
Annual change in rate of unemployment (U(t)-U(t-1))	.350	.000
Old aged (65+) % population	.055	.002
Leftist parties in office (% cabinet seats)	.002	.011
Centre parties in office (% cabinet seats)	.003	.000
Liberal parties in office (% cabinet seats)	.007	.000
Index of counter-majoritarian institutions (Schmidt 1996)	-.097	.000
Constant	-.195	.000

R<sup>2</sup> (adjusted): .989; N = 576

Source

Table 1 and data file "POOLOECD.SAV" (20-3-1997), DV: SOCMGS05. Values for the dependent variable in 1980 and 1981 (or other years in which a break in the series impairs longitudinal comparability) are based on interpolation.

Estimates are based on OLS-PCSE (ordinary least squares regression with panel corrected standard errors [Beck and Katz 1995]) with lagged dependent variable. Reanalysis of the model with Kmenta corrections for panel heteroskedasticity, contemporaneous correlation and autocorrelation (Kmenta 1990) fully support the model above.

Table 3 allows inferences to be drawn with respect to the determinants of increasing and decreasing social expenditure-GDP ratios. Because the regression coefficient of the lagged dependent variable approximates 1.0, all other coefficients on the right hand side of the regression equation, which can be derived from table 3, can be regarded as estimates of the extent to which the predictors influence the change in social spending level compared to the previous year. Table 3 thus gives more detailed information about determinants of growth and decline of social expenditure-GDP ratios. Consider the latter case, for example. What accounts for declining social expenditure-GDP ratios?

The answer is:

- a high rate of economic growth;
- a decrease in the rate of unemployment;
- secular conservative parties in office (or, conversely, a low degree of participation in government of leftist, centre, and liberal parties);
- powerful counter-majoritarian institutions and, thus, major veto points for the opposition to welfare statist reformism, or stumbling blocks for expansionist welfare statist policies;

- and a small elderly population, and, hence, less demand for old-age pensions and care for the elderly.

Conversely, social spending-GDP ratios will grow, the more the following conditions are fulfilled:

- low economic growth, economic stagnation or recession;
- increase in the unemployment rate;
- a government composed mainly of leftist or centre parties;
- weak counter-majoritarian structures and, thus, few veto points against welfare statism;
- a large proportion of the population is elderly and, hence, enormous political pressure on the electoral market in favour of a pro-welfare statist policy stance.

This is an interesting message for those who strive for expansionary social policy reform as well as for the followers of social policy retrenchment. Take a government which, faced with large deficits in public spending, plans to reduce the level of social provisions. Under which circumstances is a policy of retrenchment successful? The experience from the OECD democracies during the last three decades suggests two things. First, that a more limited role of government in social policy is very difficult to achieve. Second, a more limited role of government in social policy has been facilitated mainly by high economic growth, decreasing rates of unemployment, a relatively small elderly population, powerful counter-majoritarian institutions, and conservative party-dominated governments.<sup>23</sup>

Most of these variables are difficult to manipulate in the short or medium-term. This is indicative of the enormous restrictions a government will be faced with if it sets out to curb social provisions, not to mention the powerful forces in favour of maintaining or expanding the welfare state. Within these limits, the leeway for decremental social expenditure policy varies from country to country. It tends to be greater in those countries in which market-oriented conservative parties have been in a dominant position, as is the case in most English-speaking nations, *ceteris paribus*.<sup>24</sup> Moreover, the scope for social policy retrenchment is wider where powerful counter-majoritarian institutions, such as federalism, and limited manoeuvrability of the central state in its spending and taxation policy, discipline the spending preferences of incumbent parties, other things being equal. A major example is the US. Whether the attempt to cut social spending succeeds or fails, depends, however, also on the rate of economic growth and, above all, the rate of unemployment. A government which presides over an accelerating "growth engine" and, above all, a "job machine", for example, can outperform the retrenchment effort of all other governments, *ceteris paribus*. Sound economic development may not in itself be the best social policy regime, but together with employment-oriented labour market interventions it helps a great deal to reduce the social

spending burden on the economy. A country in which the government, or labour and capital, or the government and the economic interest groups are capable of generating a higher employment content of GDP growth, such as the US and in the first half of the 1990s the Netherlands, is, thus, in a better position when it comes to retrench social expenditure than a country, in which the route to social expenditure adjustment tends to be blocked within the party system and the economy.<sup>25</sup>

#### 4 Social policy determinants in a most-dissimilar-cases-design

The analysis presented so far and historical studies of social policy development in industrializing countries in the 19th and 20th century (Schmidt 1997b: part 1) suggest that trends and variation in social expenditure follow surprisingly stable patterns. This may be regarded as offering empirical support for a more general hypothesis. According to this view, three classes of variables play a central role in social spending: First, socio-economic factors of the kind suggested in the socio-economic school of thought, such as demographic trends and rates of unemployment. Demographic and economic variables define the constraints as well as the conditions and resources for social policy-making. Second, a must in every explanation of social policy is a modified parties-do-matter-view. The major dividing line between political parties with regard to social policy is, in general, not the left-right difference, but rather the difference between market-oriented secular conservative parties on the one hand, and the welfare statist parties mainly of Social Democratic and Christian Democratic character on the other.<sup>26</sup> Third, formal state institutions, or "constitutional structures" (Huber, Ragin and Stephens 1993), are indeed major determinants of social policy. An example is the strength or weakness of counter-majoritarian institutions in the state apparatus: strong counter-majoritarian institutions inhibit the expansion of the welfare state, while weak counter-majoritarianism opens avenues for radical policy-making, such as the rapid expansion of social policy at all cost, if the political will to do so exists on the part of the incumbent party.

The overall result of the analysis of social spending patterns in democratic OECD nations is, thus, in a nutshell, that the trinity of socio-economic factors, partisan influence on government, and political-institutional structures<sup>27</sup> can be regarded as a powerful explanatory model of social policy in rich democracies. Socio-economic structures and processes define the social need for social policy and generate resources for coping with social policy functions; incumbent parties choose from alternatives; and political-institutional circumstances are constraining as well as enabling conditions which influence the policy choices and their outcome.

A caveat must be made at this stage of the presentation. It concerns the most-similar-cases research design utilized in this study. Within the context of this research design, political parties, political institutions, and socio-economic forces have proved to be principal determinants of public policy. The question is, whether this statement is valid across time and space, or whether it is valid only for the small group of economically advanced democracies? A complete answer to this question requires systematic comparison of social policy in rich and poor democracies and autocracies. This is beyond the scope of this article. Within its context, however, a less ambitious but nevertheless useful test is feasible; that is an analysis of the ratio of social expenditure to GDP in rich and poor countries and in democratic and non-democratic nations prior to the fall of the Iron Curtain, so that the policy experience of the former socialist countries can be taken into account. The best source available for this type of analysis is the fourteenth international inquiry into the cost of social security (ILO 1996). This inquiry presents data on social expenditure up to 1989 in many First World nations, socialist states, and Third World countries.

Do parties, political institutions, and the proportion of elderly in the population continue to matter, when the analytical focus shifts from a sample of most-similar cases, such as the economically advanced democracies, to a more heterogenous sample, comprising rich and poor democracies and autocracies? Results from recent qualitative historical research, and quantitative analysis of social policy suggest the following answer to this question (see Schmidt 1997). First, the variation in social spending as a percentage of GDP in rich and poor nations requires a more general political and socio-economic explanation. Second, the difference in social expenditure-GDP ratios in rich and poor democracies and autocracies can largely be accounted for by a model comprising six political and socio-economic determinants.<sup>28</sup> Among these, parties and political institutions do indeed play a significant role (see table 4). For example, a high level of social expenditure to GDP can largely be attributed to the following constellations of forces:

- a democratic regime effect, measured by the age of democracy indicator;<sup>29</sup>
- a socialism effect which shows that the Eastern European socialist countries tended to allocate a larger proportion of their net material product to social programmes than other countries at similar or higher levels of economic development;
- weak counter-majoritarian tendencies (measured by a federalism-dummy);<sup>30</sup>
- the presence of powerful leftist and centre parties;<sup>31</sup>
- a large wage-earners army, measured by the proportion of the population employed as wage-earners in the non-agricultural sector;<sup>32</sup>
- a large proportion of the population aged 65 or above.

The regression coefficients shown in table 4 permit a quantitative assessment of the extent to which the various independent variables have an effect upon

the social expenditure to GDP ratio.<sup>33</sup> For example, a socialist regime generates a 3.8 per cent increase in social spending as a percentage of GDP; a difference in the age of democracy of 100 years is associated with a 7 per cent difference in social expenditure-GDP ratios; powerful leftist or centre parties in government raise social spending shares by 6.9 per cent and federalism reduces the share of social expenditure to GDP by 2.4 per cent, all other things being equal.

Table 4 Determinants of social policy in rich and poor democracies and autocracies (1989)

Independent variable	Unstandardized regression coefficient	Standardized regression coefficient	Significance level
Old aged population (%) 1989	.835	.439	.000
Non-agricultural wage-earners (%) 1989	.127	.199	.021
Socialism (= 1, else = 0)	3.773	.132	.023
Age of democracy	.072	.213	.005
Federalism /non-federalism	-2.381	-.096	-.055
Powerful leftist or centre party	6.864	.217	.000
Constant	-2.78		.004
R <sup>2</sup> (adjusted): 0.832; N = 90			

Note to table 4

The estimates in table 4 are derived from a multiple linear regression (OLS) of data on independent states with a population of more than 1 million, for which ILO (1996) reports data on social expenditure. Included are, for example, the OECD member countries, most Latin American nations, Near East countries, a significant number of African states as well as Singapore and the People's Republic of China.

Sources: Banks; Day and Muller (1996), ILO (1996), World Bank (1995, 1996), Schmidt (1995, 1996).

The findings reported in table 4 together with those in the preceding sections suggest that politics in general as well as parties and institutions in particular are indeed important determinants of policy outputs, whether one considers advanced democracies only or rich and poor democracies and autocracies. This is the first conclusion.

Moreover, four of the major predictors of the social expenditure-GDP ratio – age of democracy; leftist and centrist parties (or alternatively, the absence of these determinants); counter-majoritarian institutions, such as federalism; and the elderly population – have proved to be valid predictors in a rich democracies sample and in a sample comprising rich and poor democracies and autocracies. Moreover, these predictors have passed all other tests, such as controlling for alternative explanatory factors and diagnostic statistics on autocorrelation, heteroskedasticity, and contemporaneous correlation. This

lends further support to the view that an explanatory model based on partisan variables and political-institutional structures, such as counter-majoritarian institutions and regime effects,<sup>34</sup> and socio-economic factors is a major tool in the comparative analysis of social policy spending. This is the second conclusion.

The third conclusion follows implicitly from the findings of this article. It concerns the impact of international and transnational factors. These factors have clearly played a role in shaping and constraining social policy at the level of the nation state (see Leibfried and Pierson 1995; cf. table 2 above). However, the analysis presented in this article indicates a muted role of international or transnational factors in the process of determining social policy choices and outputs. The major determinants of social policy have so far been national or domestic factors, above all political parties, political institutions, such as counter-majoritarian arrangements, socio-economic constraints and resources. Thus, the comparative study of social expenditure suggests that politics and policy at the level of the nation state continue to play the dominant role in public policy, despite increasing levels of international interdependence and transnational integration.

Notes

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1. See, for example, Zöllner (1963), Wilensky (1975, 1981), Castles (1982), Schmähl (1982), Schmidt (1982), Alber (1983), OECD (1985), Flora (1985, 1986a, 1986b, 1986c), Keman (1987), Gordon (1989), Schmidt (1989), Hicks and Swank (1992), Huber and Stephens (1993), Huber, Ragin and Stephens (1993), Janowski and Hicks (1994), Lindert (1994, 1996).

2. Broadly speaking, four schools of thought have dominated the comparative analysis of public policy in democratic nations. One of them centres attention on economic and socio-economic variables. Examples include socio-economic theories of social policy (which have played an influential role in Wilensky 1975, to cite one example) and, more recently, the hypothesis according to which international markets have grown too powerful for any national government to oppose them successfully (see, for example, Scharpf 1988; Kurzer 1993). A second family of theories explains public policy differences mainly in terms of power resources of social classes, such as the market power and the political power of labour relative to that of capital and the middle classes. A representative example is Esping-Andersen (1990). The third theory is the "partisan theory" of public policy. Policy choices and outputs are, in this view, largely driven by incumbent political parties and the preferences of their social constituencies

(see Hibbs 1977 and, for an institution-augmented view, Schmidt 1996). According to a fourth school of thought, mainly institutionalist in character, policy differences are largely attributable to differences in political and economic institutions as well as to differences in the strategies pursued by interdependent collective actors (see, for example, Scharpf 1988; Huber et al. 1993 and, with special emphasis on policy inheritance, Rose and Davies 1994). Part of the latter school is the regime effect-theory, such as the view that policy outputs and outcomes are fundamentally shaped by the difference between constitutional democracies and autocratic regimes.

3. Above all common or groupwise serial correlation (common autocorrelation in all countries of the sample or groupwise autocorrelation patterns); contemporaneous correlation (correlation of the residuals between countries); and panel heteroskedasticity (casewise or groupwise error variance). See Greene (1990); Kmenta (1990); Katz and Beck (1995); Kittel (1997).

4. Such as a sample composed of rich and poor nations as well as democracies and autocracies. With relatively few exceptions (such as Zöllner 1963 and Wilensky 1975), the study of social spending has largely been conducted within samples comprising rich and democratic nations only, in order to hold broadly defined levels of economic development and type of political regime constant. However, most results derived from these designs have not been tested within a wider sample of nations, including less developed and non-democratic ones. This must be regarded as a major impediment to the development of more general hypotheses on social policy.

5. For details see, for example, Flora (1985, 1986a, 1986b, 1986c); Esping-Andersen (1990, 1996); Schmidt (1997b); OECD (1985, 1994, 1996); ILO (1996).

6. Except for the last section of the article which is derived from data on social spending in rich and poor countries published by the International Labour Office (ILO 1996), priority will be given to the OECD data, which are more comprehensive and more comparable than the ILO data. The OECD data for the post-1980 period rest upon the following definition: "Social expenditure is the provision by public (and private) institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer. Such benefits can be cash transfers, or can be direct ('in-kind') provision of goods and services" (OECD 1996: 3). In policy terms, the OECD social spending data cover public social spending on compulsory social insurance, family benefits, public health, arrangement of public employees, public assistance, war victims, as well as expenditure on labour market policy, housing and social services for families, survivors, disabled persons and care. Estimates of social expenditure in the pre-1980 period were derived from OECD (1985), excluding education expenditure. Remaining breaks in the series around 1980/81 (see table 1) were bridged through interpolation. The ILO inquiry (1996) into the cost of social policy uses a more narrow concept of social security guides. The ILO data covers mainly statutory expenditure of public, semi-public or autonomous bodies on medical care and benefits for risks associated with sickness, unemployment, old-age, employment injury, family, maternity, invalidity and survivor pensions. For critical reviews of the remaining limits of comparative data

on social policy see Schmähl (1988); OECD (1996); and Eberhard-Ingold (1996). For example, no reliable comparable data exist on social "tax expenditures" and private or semi-public social security efforts.

7. See footnote 2.

8. Note that the classical explanation of the partisan theory of public policy (Hibbs 1977) and most of the later work on partisan impacts on public policy was based on bivariate models. However, alternative theories of social policy, have also often failed to do justice to competing explanations. Thus, for example, Zöllner (1963) did not systematically investigate the impact of political variables, which, he believed, was insignificant. Conversely, studies of the impact of political parties, such as Castles (1982) and Schmidt (1982), as well as the proponents of "power resources theory", such as Esping-Andersen (1990), tended to disregard the impact of formal or informal constitutional structures on social policy.

9. The alternative strategy focuses attention on disaggregated data. This approach doubtlessly has merits, as the programme approach to public spending demonstrates (Rose 1984). Its weakness is the limited potential for data reduction.

10. See Greene 1990, Beck and Katz 1995. In contrast to the mainstream literature on the welfare state, a comparison of similar and dissimilar cases (e.g. rich and poor nations as well as democracies and autocracies) complements the comparison of most similar cases (i.e. economically advanced democracies) in this study. This serves to explore the generalizability of the findings from a most-similar-cases-design.

11. The analysis reported below has largely been based, following Beck and Katz (1995), on PSCE-OLS estimates (ordinary least squares with panel-corrected standard errors) and on FGLS (feasible generalized least squares) which corrects for common and groupwise autocorrelation, heteroskedasticity and contemporaneous correlation (Kmenta 1990).

12. The lagged dependent variable and the policy inheritance argument are introduced in the second stage of the analysis (see table 2).

13. The level of intercorrelation between the independent variables does not exceed a Pearson's  $r$  of 0.56. It is, thus, considerably below the critical level of multicollinearity.

14. Defined as the proportion of the population aged 65+.

15. Defined as the total number of years since the introduction of male and female suffrage.

16. In contrast to the left-right dichotomy in earlier welfare state research (such as Castles 1982, and Schmidt 1982), the major division on social policy among political parties is, thus, between the pro-welfare state parties of Social Democratic and Christian Democratic character on the one hand and secular conservative parties on the other (for details about measuring the various political-ideological families of parties see Schmidt 1996). More ambiguous is the role of the liberal parties in Europe. Most European liberal parties prefer a pro-market oriented stance in social policy. But, although the Liberals claim the role of the defender of small government and the proponent of big markets, incumbent liberal parties have tended to tolerate the policy of welfare state expansion. This can be largely attributed to compromise requirements of the coalitions in which the Liberals have participated: typical has been a coalition with one of the "social policy parties", i.e. mainly the Christian Democratic Party or the Social Democratic Party. Thus, despite

their pro-market programme, most incumbent liberal parties in Europe acted as collaborators in the dramatic expansion of social policy in the post World War II era.

17. Measured with a dummy variable (1 = single party government, 0 = other).

18. The index measures the total number of major institutional constraints of central state government in the period under investigation (for details of measurement see Schmidt 1996: 172-3). The index is based on the unweighted combination of six dummy variables (1 = constraints, 0 = other): 1) degree of centralization of state structures (1 = federalism); 2) difficulty of amending constitutions (1 = very difficult, 0 = other); 3) strong bicameralism (1 = strong, 0 = other); 4) central bank autonomy (1 = autonomous, 0 = other); 5) referendum (1 = frequent, 0 = rare). High values indicate powerful constraints, low values indicate that central state government has a great amount of room to manoeuvre.

19. Measured by OECD data on exports and imports as a percentage of GDP.

20. Separate analysis (not reported here) of ILO data on social expenditure in the period from 1960 to 1989 (PCSE-OLS estimates) are generally consistent with the model in table 2, except for the import-export-measure, which is insignificant. In view of the lower level of comparability of the ILO data, the latter result must be regarded as tentative.

21. Measured as the percentage point difference in social expenditure (as a percentage of GDP) against the previous year.

22. The level of correlation between the independent variables (maximum:  $r = .76$ ) is below the critical threshold.

23. This is not the only route to welfare state retrenchment. It is conceivable that governments which plan to reduce social spending fully exploit the greater amount of room to manoeuvre that weak counter-majoritarian structures circumscribe. The cuts in the Swedish welfare state in the 1990s is an almost perfect example of that possibility (see, for example, Stephens 1996).

24. But note that the explanatory power of the latter variables, excluding the lagged dependent variable, is rather limited. Change in social policy expenditure and the possibilities of expansionary and restrictive expenditure policy need to be studied much more closely both from a comparative angle and a case study approach.

25. The latter constellation of factors tends to characterize the impasse of the effort to control social expenditure policy in some of the most developed welfare states, such as France, Italy, and Germany until the present time (winter 1996/97).

26. Van Kersbergen has argued this case particularly convincingly (van Kersbergen 1995). The analysis presented in this article fully supports van Kersbergen's "social capitalism"-theory. However, it must be added that the Christian Democratic parties tend to adopt a more restrictive stance in social policy in periods of low growth and high public debt.

27. Less pervasive is the impact of international or transnational factors.

28. The following model is based on earlier comparisons of social spending in rich and poor countries (such as Zöllner 1963, Wilensky 1975, and Schmidt 1989). It adds to the latter models three central variables of the explanation advanced in this article so far, i.e. parties in office and political institutions, above all counter-majoritarian institutions, and the age of democracy. The focus in this section of the article is on

those rich and poor states with a population of at least one million for which the ILO (1996) has published data on social spending-GDP ratios.

29. The measure for the age of democracy is the total number of years from the year of introduction of universal suffrage to 1989.

30. Due to non-availability of comparable data for all the countries involved, federalism was taken as a proxy for the index of counter-majoritarian institutions.

31. Measured by a left-centre dummy scored "1", when the average share of cabinet seats of democratically elected leftist and centrist parties in 1950-89 exceeds the 66.6% mark, other = 0.

32. This is a major part of Zöllner's socio-economic explanation of social policy (Zöllner 1963).

33. The level of intercorrelation between the predictors does not exceed the critical threshold of  $r = +.80$  or  $r = -.80$ .

34. A wide variety of historical studies support this view. See, for example, for social policy in 19th and 20th century Germany Schmidt (1997: part I).

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