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The Political Economy of Social Europe: The case of inclusion policies

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Abstract

EU governments have engaged in a coordinated effort to combat social exclusion. This is puzzling for empirical and theoretical reasons. The paper argues that integration of social inclusion policies can be explained by the political economy of domestic reform, driven by structural change in EU welfare states, facilitated by the new Open Method of Coordination. This explanation is contrasted with the view that European integration is motivated by EU bureaucrats' interest in expanding their competencies and national administrations' attempt to instrumentalise the EU for protection of their clientele.

Keywords: *Political economy of reform, public choice, Social Europe, social exclusion, open method of coordination*

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1. Introduction

Until the late 1990s, Social Europe was hardly visible compared to the internal market and monetary union. Economic integration, it was argued, puts pressure on national welfare systems but does little to sustain and strengthen them (Scharpf 1997). Most of what was discernible as social policy integration had been 'left to courts and markets' to develop, i.e. evolved as a by-product of market making in the legal and the economic system (Leibfried and Pierson 2000).

At the turn of the century, however, this evolution seems to have prepared the ground for more active social policy integration (Falkner 2000). The Lisbon Summit, in particular, was a watershed. Governments decided to implement the open method of coordination on social inclusion (Ferrera, Hemmerijck and Rhodes 2000; Mosher 2000).[1] While there is a legitimate debate on how much progress this method entails for Social Europe, a consensus has emerged that it makes a difference to social policy in the EU and its member states (de la Porte, Pochet and Room 2001; Chalmers and Lodge 2003; Schelkle 2004).

Why have EU governments been willing to communiterise in social policy matters *at all* and, in particular, why have they been willing to do so with respect to *the safety nets of last resort*? I take the example of social inclusion because it is, from a political economy point of view, a rather unlikely candidate for policy integration. Social assistance is neither required for the completion of the single market nor relevant in fiscal terms. Other conventional reasons for policy integration, such as economies of scale in public goods provision, are not particularly convincing either. But an explanation based on the political economy of reform (PER) in EU member states can shed light on this improbable instance of policy integration (e.g. Falkner 2000: 280; Mosher 2000: 7).

The PER explanation has typically been used to counter the 'globalisation hypothesis' according to which it is *external* competitive pressure which forces governments to welfare state reforms. This can either lead to downsizing for competitiveness reasons or to expansion in order to protect losers and buy off their opposition. Iversen and Cusack (2000) and the contributions in

[1] The method is explained in the next section.

Pierson (2001a) in contrast argue that it is domestic structural changes, such as demographics, deindustrialisation and fiscal crisis, that create adjustment pressure. The different regimes respond to these pressures gradually and reluctantly which is testimony to the lasting political popularity and economic salience of the welfare state.

From this perspective, the EU seems to be adding above all to already existing fiscal pressures (Pierson 2001c). It is not obvious, however, why member states would suddenly agree on new forms of integration in the social policy area. Given its finding of considerable resilience of the welfare state, it apparently does not refute the Leviathan hypothesis (LH) forwarded by public choice theorists. To them, integration of social assistance policies is yet another instance of member state governments granting EU bureaucrats a free grabbing hand to protect their domestic constituencies, thereby expanding the Commission's portfolios.[2] It thus reflects the world view of mainstream political economy as practised by economists where good politics is bad economics, and vice versa.

These alternative hypotheses have been chosen because their comparison can tell us, first, how legitimate the expansion of the EU into the social policy arena is likely to be; secondly, what is driving reforms in mature welfare states; and, lastly, how domestic reform agendas and this breakthrough in EU social policy integration is linked. Moreover, it can shed light on the explanatory power of different theories of European political economy.

The argument is developed in three steps: I discuss, first, why the EU's coordinated combat of social exclusion poses a theoretical puzzle and what the two competing explanations I discuss here have to say about it. I look, secondly, at the evidence of recent welfare state reforms that may broadly refute or confirm basic tenets of the two explanations. I argue thirdly that the peculiar form of positive integration, the open method of coordination (OMC), is key to refute the alternative LH. The last section concludes with some

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2 Brennan and Buchanan (1980) is the locus classicus for the Leviathan hypothesis in contemporary political economy, Sinn (1992) a seminal contribution on how tax competition for mobile capital may tame the beast while Rieger (2001) is an original variant applied to European integration.

remarks on how this paper contributes to the literature on the political economy of reform.

2. Why social policy integration is puzzling

The Lisbon Council spelled out the basic elements of OMC (Council 2000, point 37):

- Guidelines for social policy are combined with specific timetables for achieving short, medium and long term goals.
- The European guidelines are translated into national and regional policies by setting specific targets and measures.
- Quantitative and qualitative indicators, while tailored to the needs of different member states and sectors, make policies comparable.
- Periodic monitoring, evaluation and peer review is organised as a mutual learning process based on benchmarking.
- The Commission is in charge to distill best practices on managing change out of these repeated exercises.

The new instrument integrates, but does not harmonise, social inclusion policies. This section first outlines why it is puzzling that governments have agreed on this new form of EU governance with respect to social inclusion, then I sketch alternative approaches to solve the puzzle.

2.1 The twofold puzzle

The EU member states' coordination of social assistance policies is puzzling for empirical and theoretical reasons. Empirically, integration of inclusion policies progressed faster and went further than other areas of social policy. In less than a decade, the EU moved from the 1992 directive on the definition of sufficient resources in social assistance systems (Council 1992a) to the OMC on social inclusion (Commission 2001). This is remarkable if compared to the rather low speed of integration processes in the EU even with respect to social policies that are arguably more relevant to the internal market. E.g., Falkner (2000: 289-290) mentions cases in which the creation of a European labour market would require to amend labour laws on individual renumeration and collective representation. Perhaps this simply means that social inclusion is just another example for the union coming closer at a notoriously uneven, capricious speed. But the implementation of an OMC on inclusion policies is also remarkable if compared with the fate of initiatives launched around the same time:

- There was another directive in 1992 aiming at a convergence of objectives and policies on social protection more generally (Council 1992b). Precious little came out of it, presumably because the differences in social protection regimes are hard to reconcile (de la Porte, Pochet and Room 2001: 296-297). Yet, this could also be said of means-tested assistance which plays a very different role in different welfare regimes.
- At the Lisbon Summit in March 2000, it was also agreed that the OMC should be applied to pensions. But activity in this policy area has picked up only recently, although the Economic Policy Committee and the European Central Bank have urged governments to reform their pension systems to make them fiscally sustainable for some time (Pakaslathi and Pochet 2003: 116-117). A first joint report that contained no common indicators was accepted by the Spring Council in 2003.
- Attempts to coordinate health care policies are in their infancy although the compatibility of systems would definitely contribute to mobility of employees. And, like pension reforms, health care reforms have a far greater impact on public finances than social assistance and thus are arguably a more immediate 'matter of common concern'.

In other words, these other initiatives would have a rationale in the theory of fiscal federalism while coordination – in contrast to central financing - of social assistance policies does not (Oates 1999; Schelkle 2000).

Moreover, the Open Method brought about positive integration. For instance, governments have agreed on a set of common indicators to benchmark their systems. They have agreed on common goals, among which the emphasis on 'activation', basically re-integration into the labour market, is the most noticeable and contentious (Begg et al 2001: 6, 20-22). The Commission claims that the first joint report "gives a concrete reality to the open method of coordination on Social Inclusion" (Commission 2001: 4). It is so far the only policy document on poverty ever presented by the Commission.

This is irritating for a well-known political economy theorem according to which there is an asymmetry in favour of negative integration (Scharpf 1999: 50-83). It states that the 'zeitgeist' of supply-side interventionism and organised business interests will favour EU measures that serve to remove barriers to the mobility of factors of production and commodities in order to 'make markets'.[3] In contrast, integration measures to protect consumers and labour, primarily to correct markets, are less likely to materialise. Typically, the interests served by positive integration are less vocal and, above all, the sacrifices in terms of national sovereignty more severe. Since governments are usually more inclined to acknowledge differences than to give up parts of the national regulatory framework, positive integration is difficult to achieve.

The coordinated combat against poverty and social exclusion has only an indirect link to the mobility of labour. The freedom of movement in the EU is materially guaranteed for employed workers only, not for those of working age receiving social assistance. Only insofar inclusion measures improve the employability of jobseekers do they help to fulfil a precondition for labour mobility. But they are not meant to increase the spatial mobility of transfer recipients, thus contributing to the integration of European labour markets. Therefore, the OMC can be interpreted as an attempt 'to rebalance [...] the structural asymmetry between negative and positive integration' (Ferrera, Hemmerijck and Rhodes 2000: 65). Yet this rebalancing act is theoretically puzzling given that the socially excluded do not dispose of effective lobbies driven by economic interests which contradicts a central assumption of the asymmetry theorem.

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[3] A standard that ensures compatibility between different national regulations is a measure of negative integration. A common standard of health regulations to provide for the same level of protection to all EU consumers is a measure of positive integration.

2.2 Possible solutions to the puzzle

This subsection outlines two attempts at solving the puzzle why this leap in social policy coordination has occurred and why with respect to an area that is not of major concern to the median voter and fiscally rather marginal. The theoretical sketch serves, first, to highlight the specifics of a PER explanation and, second, to obtain a guide to the wealth of evidence that is notoriously difficult to interpret.

In my view, a PER explanation sees the open method as a means to deal with opposition to the domestic reform agenda and contains imminent systems competition at the same time. There is, first of all, a domestic reform agenda which may be driven by deindustrialisation or the weakening of the family as a safety net. Social exclusion problems resulting from these developments are specific to the different 'worlds of welfare capitalism' (Esping-Andersen 1990; Ferrera 1996; Begg et al 2001: 17-20). But the worlds have in common that they are difficult to change, due to the inertia of institutions and the resilience of entrenched interests they helped to create. Thus, internal reform pressures are not simply 'overwhelming', politicians have to make them appear irresistible.[4] Moreover, even if they succeed in convincing the pivotal voter of the need for reform, policymakers who seek reelection have to think about excuses in case of failure. This may entail shifting blame to a scapegoat like 'globalisation' or 'Brussels' but it may also mean seeking acceptance for learning experiences in unkown territory. In short, an analysis in line with the PER involves three steps:

1. Its point of departure are domestic reform pressures, a political 'demand' for reform, that this approach claims to be the prime mover based on thorough empirical studies (Pierson 2000a; Scharpf and Schmidt 2000; Iversen and Cusack 2000).

2. It is a political economy approach in that it goes on to explore the institutional obstacles and political opposition to reforms,

[4] Cf. Schmidt (2000) for a detailled argument on political entrepreneurship as a necessary ingredient to sustained reform processes in OECD countries, Hemerijck and Schludi (2000) for successful and unsuccessful cases, and Kitschelt (2000) on the question when and how governments pursue unpopular reforms.

the need for which is typically taken for granted. Given the emphasis on resilience despite considerable pressures for adjustment, this approach expects to find restructuring as a result of welfare state reforms rather than outright expansion or retrenchment (Pierson 2000c).

3. Against this background the approach looks at the political techniques, the specifics of the 'supply side', which make politicians look active, i.e. tackling the problems which they promised to fix while avoiding the blame for reform failures.

Notably, the first proposition, namely domestic pressures urge governments to attempt reform, implies through the third proposition that social policy integration has to be seen as *an instrument* to push through unpopular domestic reforms rather than as a functionalist outcome of EU market integration. This instrumental view of integration is the main argument that qualifies the asymmetry theorem stating a discrepancy between a functional requirement and the reality of integration.

The PER leads us to observe the following:

- Source of reform pressures: Governments have tried to reform social assistence policies because their regime-specific social exclusion or poverty problems were (perceived as) becoming worse and thus politically embarassing.
- EU involvement: Despite these internal pressures, reforms in this marginal policy area do not get easily off the ground against the opposition of professionalised and respectable organised interests like the church and other charities; only after governments tried unsuccessfully were they ready to give the EU a role. The EU could claim that it has to play a legitimate role given the systems competition that is likely to result from integration.
- Impact of coordinated reforms: Some qualitative restructuring of welfare states should be discernible even if quantitative or aggregate indicators do not show much change; a social policy area like social assistance which is not popular with the middle-class median voter is likely to become more stringent as regards eligibility for and generosity of transfers.

To contrast this approach with the LH of policymaking: This public choice approach suggests that integration of social assistance policies has to be seen as yet another expression of the inherent tendency of the state in general, the EU in particular, to expand. It has three defining elements (Brennan and Buchanan 1980: ch.2; Sinn 1992: 178-180):

1. Government is 'despotic' in the sense that an administration in office cannot be effectively constrained by the electorate. Brennan and Buchanan (1980: 17-24) explicitly dismiss the median voter theorem or more generally an effective impact of electoral demand on ongoing political processes. The political process and the provision of public goods are thus driven by the 'supply side'. Obviously, the 'democratic deficit' in the EU can be seen as a variant of this despotism. Rieger (2001), for instance, argues that the democratic deficit is the very core of the EU and makes the EU set-up effectively a unitary, not a multi-level governance structure. Non-democratic mechanisms may work, however, like households' voting with their feet or capital flight. Both exert their influence through an immediate impact on tax revenue.

2. The political economy element here means that government is non-benevolent. The goals of self-interested policymakers cannot be condensed into a social welfare function. They boil down to revenue maximisation in excess of what is necessary to produce the public goods provided. Waste, distortionary taxation and excessive regulatory competencies are what this view would expect as the normal outcome of government activity.

3. Government acts analogously to the manager of a club. Most public goods that the EU member states or the EU itself produce are club goods: they rival in their use since subsidised access leads to 'overcrowding' of universities or queueing at the National Health Service; moreover, consumption can be effectively excluded by stipulating access on national or EU citizenship. This gives national governments or the EU the opportunity to distribute benefits exclusively to some members of the club which incidentally may be the policymakers themselves.

This view finds basic assumptions of the asymmetry hypothesis questionable. In particular, it is unfathomable that governments engage in negative integration to make markets since unfettered market forces contain their effectiveness of intervention. Positive integration is likely if it helps the club managers to attract additional resources and to protect members of their club (e.g. Berthold and Neumann 2002: 23-25). Empirically, the three elements of the LH make an observer to expect the following:

- Source of reform pressures: There should be a secular rise in aggregate social expenditure, a trend that is only broken if countries experience an exodus of the mobile factor capital.[5] Despotic governments if constrained to finance the expenditures necessary for reelection takes recourse to deficit financing until that is again resented by firms and households. Thus, EU market integration or globalisation more generally should have been the force that disciplined governments, if at all, because mobile capital can locate more easily elsewhere or because taxpayers become more aware of alternatives and respond accordingly.

- EU involvement: We should observe a secular expansion of EU involvement in the social policy field that cannot be justified on normative grounds. Since the EU does not raise revenue itself, its non-benevolent character in this area must show up in portfolio maximisation with the methods of intervention providing ample opportunity for discretion.

- Impact of coordinated reforms: The LH entails a distinct proposition on how governments or the EU provide poverty relief (Brennan and Buchanan 1980: 28). The non-benevolent character of public administrations as well as the club good features of their output typically make them reluctant to give cash transfers to the poor. But they are ready to expand services or labour intensive forms of poverty relief since this provides additional jobs in the bureaucracy. Thus, the coordinated combat of social exclusion should favour reforms that render

[5] Another mechanism to tame Leviathan is a noticeable increase in the shadow economy but I will not explore this here. See, from a public choice perspective, Schneider and Enste (2002) on the evidence.

social assistance less generous as regards cash transfers while expenditure on personnel may even increase.

This contrast of two political economy approaches, besides providing general solutions to the puzzle stated earlier, gives us distinct propositions about the evidence to be explored.

3. What the evidence tells us

The following review is selective in that it looks only at the evidence that is contested between the two explanations just outlined.

3.1 Sources of reform pressures

The prime mover of reform efforts is structural change in the domestic economy according to PER, the external pressure of capital flight according to LH. I will first look at the record of reform in EU welfare states. Then I briefly look at a possible correlation between capital flows and the growth of social expenditure. The final piece of evidence stems from a summary of the evidence on domestic versus external pressures for welfare state reform.

Boeri (2001) explores the intensity and direction of reforms in the area of employment protection legislation, nonemployment benefits (including social assistance) and pensions from 1986-1997. This is a time period before an OMC on social inclusion was seriously considered. Two results are outstanding. First, the 14 countries (excluding Luxembourg) have undertaken 198 reforms in a decade, i.e. more than one reform per year and country. This activism hardly justifies the stereotypical diagnosis of 'Eurosclerosis' that haunts EU member states ever since the early 1980s. Second, most countries have undertaken reforms that are fairly balanced as regards a restrictive and an expanding stance. Only with respect to nonemployment benefits did most countries try to make the systems less generous.

Ditch and Oldfield (1999), updating the first comprehensive survey of social assistance systems in the OECD by Eardley et al (1996), support this latter finding for the narrower category of social assistance. Most countries were 'consolidators', i.e. undertook marginal reforms that made existing eligibility criteria like work tests more stringent (e.g. France and Germany) or lowered benefit levels (e.g. Finland and Sweden) without changing the system. Of all EU countries, only Portugal sought to extend the provision of social assistance, starting from a very low base, in 1993. Until the late 1990s, the UK was the sole 'innovator' in the EU, introducing a Family Credit, a New Deal for Lone Parents and a Jobseeker's Allowance which together amounted to a coherent 'welfare to work' package.

The evidence supports the first step in the PER explanation, namely that governments have undertaken domestic reforms even prior to formal EU involvement. But was it, as the LH proposes, perfect capital mobility which forced them to reform before they then decided to redraw the boundaries of the club? The balanced nature of reforms, documented above, is not reassuring for the LH. This was at a time when the internal market programme raised capital mobility. Chart 1 explores this correlation which allows for both directions of causation. To get a sense of direction, two different time periods have been chosen, namely the real growth rate of public social expenditure from 1980 to 1998 which is plotted against the net capital outflow between 1986 and 1998. Each point represents an EU member state.[6] The LH would suggest that capital is driven out by rising expenditures which subsequently induces governments to form a policy 'cartel', i.e. to integrate social policies.

The admittedly rough sketch indicates close to no relationship between the rise in social expenditure (in constant 1995 prices, at purchasing power parity exchange rates to the US-$) and the net capital outflow (measured in US-$) over a longer time period. The visual impression of a positive correlation is driven by the outlier Germany in the upper right hand corner which has high capital outflows and high growth of social expenditure. Without it, a regression line would basically be horizontal indicating no statistically significant relationship.

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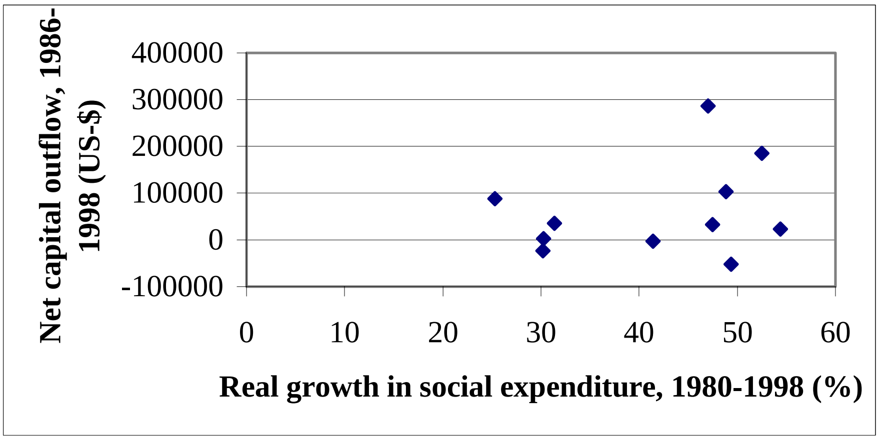
6 For lack of data in earlier years, Greece, Ireland and Portugal are excluded; Belgium and Luxembourg were excluded because there is only consolidated data on capital flows for this currency union.

Chart 1: ***Net capital outflows and real growth in public social expenditure for 11 EU countries***



Source: OECD (2001)

The LH also expects that openness will lead to *smaller* welfare states because that is what brings capital and jobs, thus raising the re-election chances of politicians (Sinn 1992: 183). In another context, Iversen and Cusack (2000), Iversen (2001) and Pierson (2001b) directly explore the evidence for internal structural changes against evidence for 'globalisation' as the prime mover. The 'globalisation' hypothesis they are arguing against claims that open welfare states will have to be *bigger* in order to sustain democratic support for world market integration.[7] Still, some of the evidence they provide *in favour* of structural change also speaks to the public choice variant of the globalisation hypothesis:

- Structural change accounts for the diversity of social exclusion problems countries face. The shift to service sector employment means a rise in marginal, low-paid jobs. The transformation of household structures like the rise in family break-up, out-of-wedlock births, and single parent households means that the family as a pillar of social welfare has been weakened and this means different things in different welfare regimes (Esping-

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7 For the (functionalist) requirement in favour of the 'open-and-*therefore*-big' welfare state cf. Rodrik (1998), Garrett (1995) or Rieger and Leibfried (2001: 43-48).

Andersen 1999). This diversity itself defies the notion that it is one factor like ‘globalisation’ or, more specifically, ‘mobile capital’ that can explain the picking up of reform activities (Pierson 2001b: 100).

- More rigorous quantitative assessment indicates that deindustrialisation, i.e. the sectoral shift of employment to the service sector away from manufacturing and agriculture, is positively correlated with a rise in welfare spending (Iversen 2001: 54-55). In particular, ‘capital openness’ is not statistically significant as a determinant of welfare spending in the regression analysis of Iversen and Cusack (2000: 321-322).

Moreover, there is evidence for the importance of partisan politics and labour market risks that explain welfare state restructuring. All this is hard to reconcile with the LH because it means that electoral demand factors have an impact on reform processes.

3.2 EU involvement

If there has been reform, the PER suggests that ‘demand factors’, i.e. electoral representation and interest intermediation, have influenced this process. Consequently, the EU’s involvement now must be broadly popular for the very reason that the welfare state is broadly popular even if not every involvement or any policy, respectively. The LH, in contrast, presupposes that EU involvement caters to a certain clientele for which the median voter has to bear the costs. Social policy competencies of the EU should therefore be unpopular.

The Eurobarometer of Spring 2003 reports responses to the question whether the 1000 respondents of each country “think that the decisions should be made by the [own] government, or made jointly with the European Union” with respect to 27 policy areas. Answers are reported in percentages where N means “decisions should be taken *N*ationally”; S “decisions should be *S*hared” and U that respondents were “*U*ncertain” (N+S+U=100). Each cell of table 1 – which is an update of Alesina, Angeloni and Schuknecht (2001) - has been calculated by taking the difference between those in favour of shared responsibilities (S – N) and weighting it with the share of certain respondents (multiply with [1-U/100]). Thus, the weight is lower the more uncertain respondents are (percentages are rounded). The larger the number in each cell, the stronger the preference in favour of ‘shared’ responsibilities in the respective country. The maximum theoretical entry is 100 indicating a unanimous preference for ‘shared’, the minimum is -100 indicating unanimity in favour of ‘national’.

Table 1: ***Desired allocation of policy responsibilities[a] according to Eurobarometer (2003)***

	Social exclusion/ poverty	**Unemployment**	**Health and social welfare**
Austria	17	2	-48
Belgium	21	-2	-29
Denmark	14	-25	-67
Finland	3	-40	-80
France	34	14	-47
Germany	29	-8	-39
Greece	43	37	-19
Ireland	35	10	-20
Italy	49	29	-9
Luxembourg	31	-22	-37
Netherlands	17	-20	-33
Portugal	28	18	-1
Spain	45	14	-9
Sweden	5	-23	-82
United Kingdom	14	-28	-35
EU-15	32	1	-30

a % >0: balance in favour of shared responsibility EU and national gov.t
Source: Eurobarometer (March 2003, tables 7.8); own calculations.

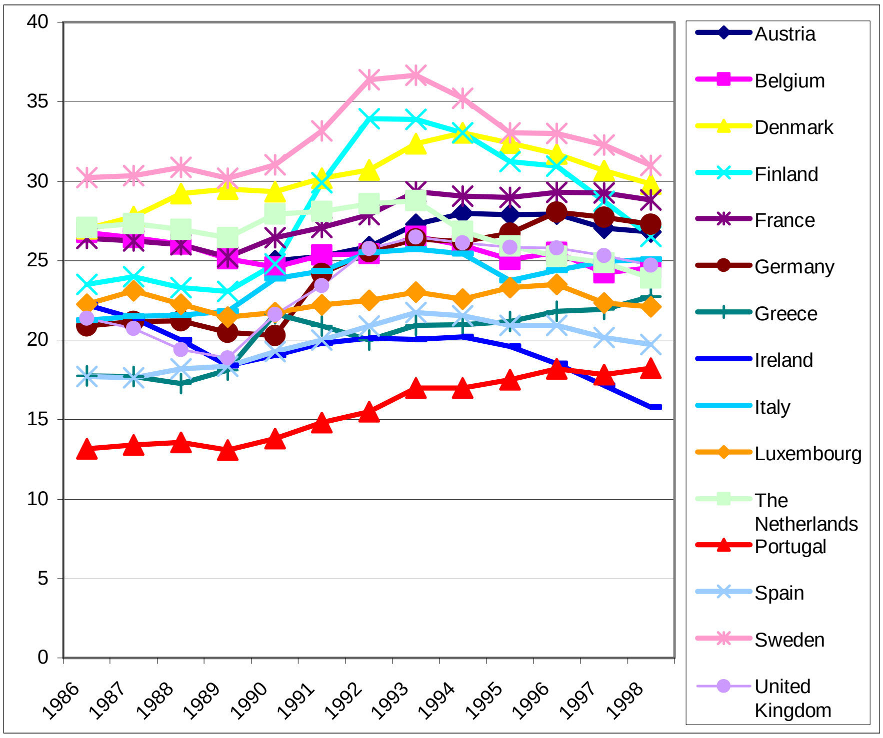
The table shows the results for just three social policy areas. The difference as regards the popularity of EU involvement is striking: Respondents are quite sympathetic to shared responsibilities in social inclusion, have very different views as regards unemployment and definitely do not want EU responsibilities in health and social welfare. But is also important to notice the heterogeneity of preferences across countries: the minimum (3 in Finland) and the maximum (49 in Italy) in favour of shared responsibility for social inclusion policies are quite far apart. This suggests that a highly centralised and harmonised EU approach to this policy domain would not be popular. This result is a blow to the LH view of governments' despotism. The EU is most active in a social policy area that is supported by a majority of national electorates.

3.3 Possible impact

So far, the review of the evidence suggests that the source of reforms was domestic changes rather than external competition. That governments responded quite vividly to these pressures is in line with the PER, difficult to explain for the LH. Yet, we have only assessed the qualitative direction of reforms. LH proponents could still claim that governments use qualitative changes only to expand social expenditures quantitatively (e.g. Fehn 2001: 26; Lindbeck 1999: 83). To take the favourite case of public choice theorists, Sweden: between 1993 and '98, social assistance benefit levels per capita were lowered, yet aggregate expenditure on social assistance doubled (Ditch and Oldfield 1999: 68). Therefore even restrictive reforms may increase spending, along with the expansionary ones, and this would be in line with what the LH expects if pressures from capital markets are ineffective. Less comfortable for the LH is that the Swedish pattern, a kind of reverse Laffer effect (lower transfer rate leads to higher overall expenditure), was also observed in the UK under the Thatcher administration. In contrast, the PER predicts that domestic reforms show up in a discernible shift in the composition of welfare expenditure while the effect on the level of spending could go either way or simply level off. Therefore, let us look at the evidence on the level and then on the composition of social expenditure.

What we observe is a levelling off of welfare spending.The range of spending levels has slightly sshifted upwards, from below 15 percent of GDP (Portugal) and 30 percent (Sweden) to slightly above almost 16 percent (Ireland) and almost 31 percent (Sweden). We also observe little convergence of spending levels (with the exception of Portugal). This levelling off across all countries is hard to reconcile with the LH which proposes that welfare spending stops rising only after the leaner welfare states caught up and reached the 'growth to limits' as signalled, for instance, by massive capital flight or tax protests.

Chart 2: ***Changes in the level of social expenditure, 1986 – 1998***

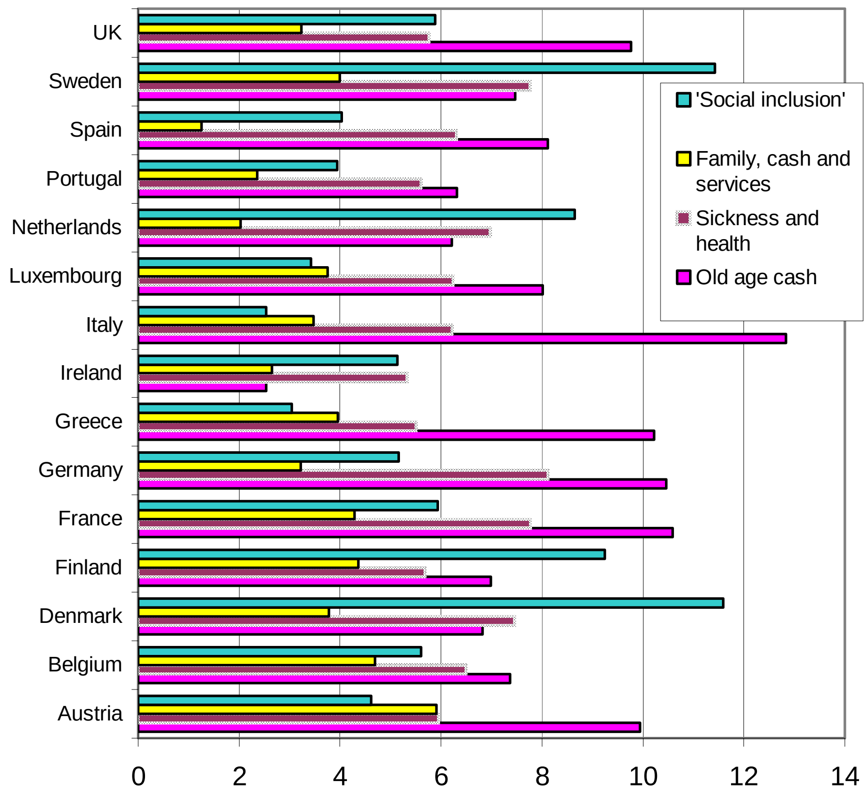


Source: OECD Social Expenditure Database, 2001

Data for Austria starts in 1990.

But is restructuring discernible as the PER leads one to expect? The following chart shows the shares of major expenditure components in 1998, the following table then documents the changes compared to 1986. I have lumped twelve categories of the OECD social expenditure database into four, namely (i) old age cash benefits, (ii) health and sickness benefits, (iii) family benefits (cash, services and for survivors) and (iv) spending on the combat of 'social exclusion'. The latter comprises all expenditure on unemployment and active labour market programmes, disability cash benefits and services (including services for the elderly), on housing benefits and for 'other contingencies', the latter including 'low income', i.e. social assistance in a narrow sense.

Chart 3: ***Structure of public social welfare spending (% of GDP), 1998***



Source: OECD Social Expenditure Database, 2001
1986 data as shown for Austria is from 1990.

This consolidation of the OECD categories makes spending on social inclusion the third largest category (after old age cash and health/sickness) in most member states. In Denmark, Finland, the Netherlands and Sweden this item is then the largest while in Austria it is the smallest.- 'Occupational disease' has been left out which is a tiny share of public expenditure in all countries.

The changes if compared to 1986 have not been fundamental. As table 2 shows, spending on old age cash and health plus sickness benefits has gone up in a majority of countries. The balance is roughly even for expenditures on family benefits and social inclusion. Arrows in parentheses indicate minor changes of around 0.5 percent of GDP, a blank cell no change. This underlines what has been said in section 3.1, namely that reforms have been fairly balanced.

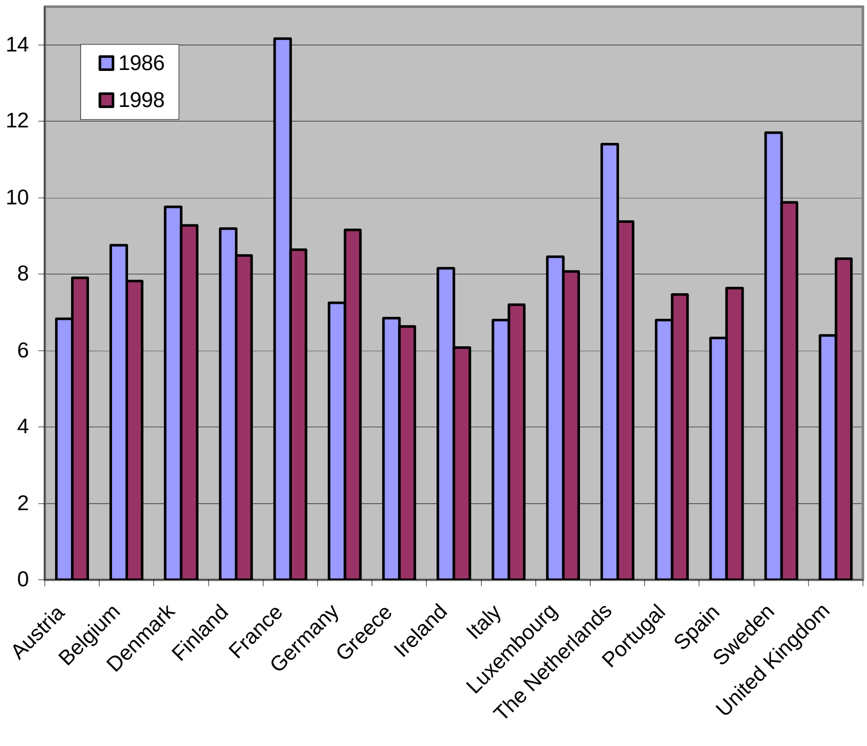
Table 2: ***Direction of spending in four social policy areas, 1986 compared to 1998***

	AU	BE	DK	FIN	FR	GE	GR	IRL	IT	LU	NE	PO	SP	SW	UK
OAC	(↗)	↗	↗	(↗)	↗	↗	↗	↘	↗	↗	(↘)	↗	↗		↗
SBH	(↗)		↘	↘	↗	↗	(↗)	↘	↗	(↗)	↘	↗	↗	↘	(↗)
FB		↘	↗	↗	(↘)	↗	↗		(↗)	↘	↘	(↗)	↘	↗	(↘)
SI	↗	↘	↗	↗		↗	↗	↘		↘	↘		(↘)	↗	↘
Total	↗	↘	↗	↗	↗	↗	↗	↘	↗		↘	↗	↗	(↗)	↗

OAC *Old Age Cash benefits*
HSB *Sickness Benefits and Health*
FB *Family (cash, services and survivors') Benefits*
SI *Social Inclusion (services and transfers on unemployment, housing, low income, disabled)*
Total *All public social expenditure according to OECD*

Finally, we can ask whether reforms of social inclusion policies have led to restructuring as regards the share of services relative to transfers. Chart 4 has been generated by calculating the share of spending on active labour market programmes and on services for the disabled and the elderly as a percentage of total spending on social inclusion (as defined for chart 3 and table 2). The focus on social inclusion favours policies that provide services like child care, training or drug counselling which, given the tight fiscal constraints of EU governments, is likely to come at the cost of transfers.

Chart 4: ***Share of services in spending on social inclusion, 1986 and 1998***



Source: OECD Social Expenditure Database, 2001
1986 data as shown for Austria is from 1990.

The service intensity of social inclusion policies has indeed risen in most countries. While the LH maintains that this is due to administrations' attempt at creating jobs, the PER does at least not dismiss the possibility of this being a sensible restructuring to make social assistance more effective. The data does not exclude either interpretation. This question will be briefly taken up below where I give a reason why the OMC favours 'activation' which is more service intensive (Begg et al 2001: 20-22).

This review of the empirical evidence was meant to show that it is very difficult to explain the stylized facts of governments' reform activism without taking recourse to political demand factors, such as structural change and thus shifting needs as regards social security. Even recent EU involvement can be seen as responding to popular demand. But the observable quantitative evidence also indicated that both volume and structure of social expenditure, in particular on inclusion policies, are quite resilient to change. While these results are not favourable to the LH, they also leave the PER with the question why reform efforts became coordinated in the social inclusion domain but less so in others.

4. How to explain integration in social assistance

This section outlines why integration of social assistance policies may be warranted and why the OMC on social inclusion, rather than the Community Method, has helped to bring this about. Both lines of argument are to counter the LH view that EU involvement in social policy is excessive so that electoral demand for it lacks a rationale and can only be explained by bureaucracies' inherent expansionism. Beforehand, conventional reasons for integration, i.e. spillovers of national policies due to mobility and returns to scale in public goods production, are negligeable in the case of the EU; while national social policy preferences are so heterogeneous that social policy matters should be left to member states (Alesina, Angeloni and Schuknecht 2001: 20). In contrast, I see three rationales for EU involvement, especially in a context of reform:

- Spillovers of national measures do not necessarily result from actual mobility. The notion of 'welfare magnetism' also comprises the phenomenon of perceived or virtual mobility. A public perception of migrants 'flooding' the country is typically created by media reports about singular cases that are hardly indicative of an actual increase in migration (Peterson and Rom 1990: 72-81). Since such cases become more frequently reported in the EU - as the public row between the UK and the

French government over the Sangatte detention centre indicates -, the spillovers from virtual migration are endogenous to integration. This justifies a role of the EU in social policy matters if only to show a concern about these anxieties.

- Some coordination of policies relevant to social assistance is required to make EU citizens' right to free movement effective. Mobility of persons in the EU is conditional on employment, i.e. unemployed transfer recipients of working age lose their entitlement if they leave the jurisdicion from which they receive benefits even if they cannot find a job there. Thus, it is plausible to argue that the EU's guarantee of free movement requires complementary action in the social policy field to make the formal guarantee a reality, e.g. by promoting reforms that allow recipients to take up some hours of work without benefits being withdrawn at prohibitively high marginal rates.
- The idea of 'laboratory federalism' (Oates 1999: 1131-1134) proposes a catalytic role to the EU as regards domestic reform processes. Governments that share responsibilities and face joint constraints in a decentralised setting of policymaking have reason to engage in an exchange of learning experiences. Learning experiences can be interpreted as public goods for the dissemination of which individual agents, i.e. sovereign governments, have too little incentives. It is thus the role of the supranational level to provide the public good and provide for opportunities to meet regularly. Given the idiosyncracies of different welfare regimes, we should not expect outright policy transfer, however (Schelkle 2000).

So there are normative reasons for the EU to play a role in social policy matters and this is important to note if we ask for the viability and legitimacy of an evolving Social Europe. But these reasons were valid even before the late 1990s and are valid for other domains than social inclusion as well. Thus one has to take recourse to political economy reasoning and look at specifics of EU involvement to solve the puzzle outlined earlier.

Why communiterise at all? A number of studies have shown that phenomena, called 'new poverty' (Room 1990) and 'social exclusion', became an issue of public debate by the early 1980s (Bertola, Boeri and Nicoletti 2001; Mayes, Berghman and Salais

2001). Governments needed to be seen as doing something about it. At the same time, their fiscal room for manoeuvre became more constrained since mass unemployment had risen and growth rates plummeted. The term ‘social exclusion’ allowed to portray very different phenomena as belonging to a similar syndrome, be it ‘globalisation’ or the ‘New Economy’, in any case not simply the result of domestic mismanagement. The coordinated combat of social exclusion signals activity with respect to a common problem, likely to be intensified by economic and monetary union. Although social assistance does not take up a large share of public social expenditures[8], this comes at the cost of governments having to compromise on national sovereignty.

Why is the OMC on inclusion in member states’ interest? The question begs to explain why the OMC made positive integration of certain social policies easier. First of all, the OMC is a mode of governance that does not impair ultimate decisionmaking of governments, it is of an intergovernmentalist nature. But by sharing responsibilities, coordination allows to shift blame for certain measures to the EU level (Rhodes 2000: 4; Mosher 2000: 7). E.g. reducing the generosity of the system for longterm unemployed persons may look less harsh if the government can point to benchmarks or peer reviews that show its system to exhibit comparatively strong disincentives for work. Moreover, the OMC is an orderly way for governments to signal to the public that its reforms enter unknown territory but that one is in good company of like-minded administrations. In other words, the OMC allows governments to play a two-level game (Putnam 1988) in which the EU level can not only be made the scapegoat for unpopular reforms but also an instrument to deal with uncertainty in reform processes (Schelkle 2004). However, this comes at the cost of more technocratic policymaking where ‘shared’ may be synonymous with ‘blurred’ responsibility.

Why is the OMC on inclusion in the Commission’s interest? The blame shifting rationale for the OMC from member states’

[8] Around 1990, the budget share was between 0.6% of total social protection in Greece and 21.6% in Ireland, with France (6.8%), Germany (7.6), Italy (5.6) and the UK (13.4) in the middle (Eardley et al 1996: Table 2.2). But spending on social inclusion in the broader sense (cf. graph 3) is obviously as important as that on health and old age insurance.

point of view raises the question why the Commission is prepared to play that role. After all, playing the scapegoat may destroy her already precarious legitimacy. Against that background, the 'intergovernmental nature' of the OMC may actually be a safeguard for the Commission. This mode of governance has shifted competencies and initiative back to member states while the Commission is basically confined to put external pressure on national administrations to act according to a time schedule. As the first joint report amply documents (Commission 2001: 22-23 and passim), the Commission acts as the messenger rather than as the initiator of blame and shame, in contrast for instance to competition policy. This makes perfect sense in a policy area where the EU has neither the legal instruments nor the budget to be more forthcoming. The drawback of this protected role is, of course, that the OMC is a very soft method the effectiveness of which ultimately depends on dedicated national policymakers.

Why the emphasis on labour market inclusion? From a PER perspective, it is not surprising that the OMC on inclusion has a strong tendency, critics say 'bias', to emphasize reforms that provide services to facilitate the reintegration of the socially excluded into the labour market. Again and somewhat paradoxically, demand factors of welfare state reform are likely candidates to seek an explanation. The basic social safety nets for the longterm unemployed and other socially excluded are not of primary concern to the majority because the incidence of social exclusion is concentrated among certain high risk groups (Hills 2002: 229-231) and their payment is not based on earlier contributions. Thus, means-tested welfare has to be legitimised. Workfare legitimises social assistance in that it conditions eligibility not only on low income but also on a work test or training requirement. This is particularly important in Social Europe where a sense of solidarity among EU citizens has yet to develop.

This latter argument may explain, in particular, why we do not find as much fervor to softly coordinate social policies in the area of pensions or health. Reform pressures in both areas are, if anything, even more urgent for the fiscal viability of European welfare states. EU involvement is less popular in these areas, however (cf. table 1).

5. Concluding remarks

This paper answers the question why we find positive integration in social assistance policies. Beforehand, this is unlikely, given that social policies of more immediate common concern to EMU have not become coordinated and given that there are good theoretical reasons for an asymmetry in integration working against positive integration. To highlight the specifics of my prefered PER explanation, it was contrasted with the public choice view of the welfare state and its reform.

More specifically, the PER hypothesis suggests that the theoretically puzzling integration of social inclusion policies can be explained as serving attempts at domestic reforms. Its emphasis of demand factors makes the confinement to social assistance plausible because that seems to be acceptable to, if not outright popular with, electorates in member states. In line with the explanation of these two features, the PER provides a rationale why it was not the Community Method but the intergovernmentalist OMC that has brought about this unlikely spectacle of positive integration.

How does the argument put forward in this paper contribute to the literature on the political economy of welfare state reform? The PER has traditionally debated with defendants of the 'European social model' who claim that globalisation threatens to lead to 'a rush to the bottom' of welfare standards and conclude that more open economies require bigger welfare states. The PER proponents counter these statements by showing that it is domestic and not external pressures which drove welfare state evolutions in the last two decades (Iversen 2001). I have used their evidence against the LH which is critical of today's European welfare states. The LH would have a dismal assessment of the PER finding that welfare states are resilient to (attempts at) fundamental reform. Since the underlying theory excludes electoral demand influence on post-election politics by assumption, it must be the self-interest of administrations and policymakers giving in to special interests who are responsible for this resilience. European integration is then another means to achieve national policymakers' and administrations' illegitimate goals.

If this evidence can be used to refute the LH of the welfare state and of Social Europe, it does not only contribute to the theory of welfare state reform. It also expands the explanatory power of the

PER to the realm of integration theory: why do governments seek supranational coordination to respond to what are ultimately domestic reform pressures? I suggested that the specifics of the integration method matter, in this case the OMC. This should alert the PER to the fact that its critical view of external pressure hypotheses must not make it overlook their strategic relevance, i.e. that reform strategies often deliberately *create* external pressures by way of entering international commitments. These commitments promise to work precisely because the external pressure argument resonates in public debates. But the different hypotheses of external pressure, the LH among them, mistake the means for the substance. The OMC on social inclusion may have achieved positive integration because it is implicitly based on the insight that domestic reform pressures can be reconstructed as externally imposed.

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