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## **Social Protection Strategies in Efficient and Inefficient States**

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**Abstract:**

It is well known that social and labor market policies vary greatly among the advanced industrialized countries, not just in terms of overall spending but also in terms of the allocation of resources across different programs. Scholars in political science, economics and sociology have successfully explained many of these cross-country differences; yet, we are far from a complete understanding of the social and labor market policy choices of governments in advanced democracies. This paper argues that bureaucratic capacity matters greatly to social and labor market policymaking. Social and labor market programs require a reliable and efficient bureaucracy, yet most explanations of cross-country policy variation ignore the interplay between bureaucrats, elected politicians, and voters. The basic idea of the paper is that some types of social and labor market programs involve more bureaucratic discretion than others, and it is difficult for politicians to justify spending on such programs if the bureaucracy is inefficient, corrupt, or both. We therefore expect the quality of the bureaucracy to influence spending on discretionary programs, but not spending on programs that require less bureaucratic capacity. In order to test these hypotheses, we analyze the allocation of public resources to active labor market policy (which involves very much bureaucratic discretion) and cash benefits to families (which involve much less bureaucratic discretion). We use data from 21 countries from 1983 to 2003. The main result are that bureaucratic capacity indeed influence spending on active labor market policy but not on cash benefits to families, even when controlling for a broad set of alternative explanations.

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## Introduction

It is well known that social and labor market policies vary greatly among the advanced industrialized countries, not only when it comes to overall generosity and spending levels but also when it comes to the allocation of public spending across different social and labor market programs. Political scientists, economists and sociologists have successfully explained many of these cross-country differences (Allan and Scruggs 2004; Esping-Andersen 1990; Huber and Stephens 2001; Iversen 2005; Korpi and Palme 2003), but we are far from a complete understanding of the social and labor market policy choices of governments in advanced democracies.

Although many social and labor market programs require a competent and reliable bureaucracy, most explanations of the cross-country variation in social and labor market policy do not take the bureaucracy into account.<sup>1</sup> We believe that the omission of this variable in previous analyses of social and labor market policymaking has hampered our understanding of political dynamics in these policy domains. This paper argues that the capacity of the bureaucracy to implement social and labor market programs efficiently is an important explanation for the variation in social and labor market policies among advanced economies. Specifically, we claim that if a state has low bureaucratic capacity, its government will refrain from adopting programs that involve bureaucratic discretion.

Scholars have asked two different types of research questions about the cross-country variation in social and labor market policy. The first set of research questions concern the overall generosity, coverage, and character of different welfare states or welfare regimes (see, for ex-

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<sup>1</sup> There are of course exceptions. Høge Heclø argued in his seminal *Modern Social Politics in Britain and Sweden* that the “bureaucracies of Britain and Sweden loom predominant in the policies studied” (Heclø 1974, 301). But there are few other examples, and existing studies, unlike the present one, are small-*n* comparisons (King and Rothstein 1993; Wier and Skocpol 1985).

ample, Esping-Andersen 1990, Huber and Stephens 2001, and Korpi and Palme 1998). The second set of research questions concern the program level, starting from the observation that welfare states frequently allocate social spending differently among programs (see, for example, Bonoli 2003, Huo 2008, Iversen 2009, Lynch 2006, Martin and Swank 2009, and Rueda 2007). There are strong reasons to believe that the competence and reliability of the bureaucracy explain some of the macro-level variation in the overall size and character of welfare states (Rothstein, Samanni and Teorell 2009). The research question of this paper, however, belongs to the second category: our main hypothesis is that the effects of bureaucratic capacity on social spending vary across programs (suggesting that the competence and reliability of the bureaucracy affects the *composition* of social spending).

Our research design is based on the assumption that some social and labor market programs are more difficult to implement than others, and consequently involve more bureaucratic discretion. We expect the competence and reliability of the bureaucracy to influence spending on programs that involve bureaucratic discretion, but not spending on other programs. In order to test this hypothesis, we analyze public spending on active labor market policy (which involves a lot of bureaucratic discretion) and cash benefits to families (which involve much less bureaucratic discretion), expecting bureaucratic capacity to affect spending on active labor market policies but not spending on family benefits. In the empirical analysis, we use a panel with annual data for 21 countries from the mid-1980s to the early 2000s. Our main results are that strong bureaucratic capacity has a positive effect on active labor market policy spending but no effect on cash benefits to families.

### **Explaining Social Protection Strategies**

According to data generated by the International Social Survey Program (ISSP), 40 percent of US survey respondents believe that it should be “the responsibility of government to provide a job for everyone who wants one.” In the Nordic countries, 65 percent are of the same opinion. When asked the question if it should be “the responsibility for the government to reduce income differences between the rich and the poor,” only 50 percent of US respondents answered in the affirmative, whereas 64 percent did in the four Nordic countries. Responding to the questi-

on if it should be “the responsibility of the government to provide a decent standard of living for the unemployed,” 50 percent of US respondents said yes, much less than the figure for the Nordic countries, which was 81 percent (Bechert and Quandt 2009).

However, it is not self-evident how this evidence should be interpreted. One explanation for the cross-national variation in attitudes to the welfare state emphasizes left-right ideology and political mobilization. The values of social democratic parties and blue-collar trade unions have had more of an impact in the Nordic countries than in many Anglo-Saxon countries such as the United States. According to this interpretation, the causal link goes from ideology (or norms) to policy preferences. Another explanation is that citizens believe themselves to be more or less likely to be net beneficiaries of spending on social and labor market policies. Here, the causal link goes from perceptions of self-interest to policy preferences. (These perceptions may not be accurate. For example, the majority may falsely believe that certain social policies will mainly benefit well-identified minorities even if this is not actually the case.) A third type of explanation concerns the organizational level of politics. In this category of models, the power configurations of interest organizations and political parties play the dominant role.

The explanatory variables that we have mentioned so far – ideology, perceptions of self-interest, and organizational power resources – are all located outside the state itself. We wish to suggest an explanation of the substantial variation in survey responses and actual policy choices across countries that is more political in the sense that the quality of government institutions is the main explanatory variable.

It should be noted that the survey questions above do not ask if it would be a good thing *in general* to support the less fortunate in society. The respondents are asked if “the government” should perform these tasks. Thus, the questions do not only tap into policy preferences but also attitudes and beliefs concerning the *instrument* that is supposed to carry out policy. It is perfectly reasonable to be in favor of economic support for the unemployed or the poor while at the same time distrusting the “government’s” capacity to implement such policies in a responsible, effective, and legitimate manner. Voters and politicians who hold such views may

well prefer not to spend public money on the unemployed and the poor, perhaps leaving these tasks to other institutions, such as voluntary associations (churches, unions, charities) and families (or clans, which are networks of families).

In other words, even if citizens and politicians believe that social protection and redistribution are legitimate political objectives, they may have more or less well-founded suspicions about the efficiency of the bureaucracy. On the one hand, they may believe that the bureaucracy is not sufficiently *competent* to carry out complicated policies in a legitimate and efficient manner (government is frequently associated with heavy handedness, bureaucratic hassle, implementation failures, and discriminatory practices). On the other hand, they may believe that the bureaucracy is *unreliable* because of corruption or other forms of malpractice. Either concern might reasonably lead citizens and politicians to believe that the return on public investments in social and labor market policy programs is too low, since much of the funding will be in vain, squandered or diverted. Since competence and reliability are both aspects of efficiency and play very similar roles in our theoretical model, we use a composite measure of the “Quality of Government” in our empirical analyses, which includes both of these dimensions.

With a few important exceptions, most existing comparative welfare state research has ignored the problem of bureaucratic capacity. This is questionable, since comparative survey-based studies show that citizen perceptions of government legitimacy depend more on opinions of how well policies are implemented and respect for the rule of law than on views about the government’s respect for democratic rights (Gilley 2006). To use the language of systems theory, the political system’s output legitimacy is more important than its input legitimacy. A recent study of eighteen western OECD countries shows that the quality of government matters as much to government social spending and benefit generosity as the political orientation of governments (Rothstein, Samanni & Teorell 2009).

There are strong reasons to believe that public support for social policies is particularly sensitive to the quality of government (compared to other policies such as, for example, investment in infrastructure). Citizens may believe that even well-meaning and benevolent politicians lack control over the bureaucratic machinery that will be responsible for the implementation of

the policy. Minorities are likely to be sensitive to systemic discrimination. Citizens with low education are likely to be concerned about their chances of claiming their social rights from well-educated civil servants, especially if policies come with a complicated system of rules and regulations. Many citizens are likely to be worried about the integrity issues that are often imbedded in the implementation of social and labor market policies. Questions about the competence of civil servants are often raised, not least when it comes to policies that involve “human processing.” With individualism on the rise, the lack of “voice and choice” in many government programs has also become an important issue. Parents may want the government to provide schooling for their children, but they may also want to have a choice between different types of schools and a say in what takes place in the classroom. Moreover, in many social policy programs it is likely that questions about the government’s ability to handle allegations of abuse and overuse will become important: people may be willing to support generous unemployment insurance and social assistance programs, but only if they trust the government to monitor the job search behavior of the unemployed. Finally, the question of corruption – in its many forms – is high on the agenda in several countries.

However, this bleak picture of the capacities of government to implement social policies should be moderated. We expect some social and labor market policies to be more sensitive to problems associated with bureaucratic efficiency than others. We believe that the key factor is the level of *bureaucratic discretion*. One of the most well-known definitions of corruption is that it is a function of the degree of monopoly power plus the degree of discretion minus the degree of accountability (Klitgaard 1988). Other problems associated with bureaucratic discretion, apart from corruption, can be analyzed in similar ways; bureaucratic discretion has been an important theme in studies of policy implementation generally, where the problem is not necessarily that bureaucrats use their discretion in immoral ways – they may simply make the wrong decisions due to a lack of resources, bad training or lack of understanding of the overall policy goals (Lipsky 1980; Lundquist 1987; Winter 2003).

If the monopoly plus discretion minus accountability formula is correct, this would imply that social and labor market policies where the government agency is the sole provider, where civil servants have a lot of room for maneuver when it comes to handling cases, and where it is

difficult to introduce effective systems of accountability are more susceptible to the quality of government problem than other programs. Active labor market programs (ALMPs) is a particularly good example, which is why we have chosen ALMPs as one of the test cases for our theory.

### **Public policies and bureaucratic legitimacy**

On a general level, active labor market policy seems to be a very sensible public policy and it has been extensively supported by the OECD (Armingeon 2007). From a macroeconomic perspective, ALMP can be seen as a Keynesian investment in human capital. Since the unemployed have to be supported in some way – either through unemployment insurance or through various forms of social assistance schemes – it makes sense to use periods of unemployment to increase the skills of the workforce. By retraining programs, workers can be transferred from declining sectors to areas in the job market that are growing. From the individual's (micro) perspective, participating in work projects or training programs where skills can be utilized in a socially meaningful way (or increased) is often preferred to being idle. By taking part in active labor market programs, unemployed individuals can also maintain their “working habits,” and avoid the type of social isolation and stigmatization that often is the result of longer periods of unemployment (Anderson 2009). There is also a social justice argument for active labor market policies: the unemployed often have low education because they not been able to take advantage of the freely available (or subsidized) education system. Increasing their skills by offering them various vocational training programs may seem like a fair compensation.

The extent to which active labor market policies are carried out varies greatly among the Western OECD countries (Rueda 2006; Bradley and Stephens 2007). We suggest that one reason may be that these are policies that by their very nature have to be implemented with a large amount of bureaucratic discretion. The first thing to notice in this discussion is that there is no such thing as a universally unemployed person. All unemployed persons vary in their skills, experiences, levels of education, and opportunities to make use of vocational training or relief



works, and also in if it is possible for them to move to regions where they may find new jobs. In order to be successful, the various instruments of active labor market policy must therefore be adjusted to the specific needs, capabilities and motivations in each case. It should be added that when organizing vocational training programs, the public authorities in charge must have the capability to make the right type of predictions for what sort of skills that will be needed in various branches. Educating unemployed persons for branches that are in decline or giving them skills that are not in demand will delegitimize the policy. Relief work programs need to be planned and executed so that they do not drive out jobs that would have been carried out anyway in an open labor market. There is also a fine line between acceptable relief works and what will, in the public eye, be seen as “phony jobs.” There is of course also a significant risk that relief work programs will be used by politicians to strengthen clientelistic structures (Weir 1992, 125).

These observations about the need for high quality implementation in active labor market policy are not theoretical constructs. A case in point is the efforts made in the 1970s in the United States to launch a federal active labor market policy known as the Comprehensive Employment and Training Act (CETA). Despite strong support in the public opinion for the notion of work ethic that this program was based on, this active labor market policy largely came to an end because accusations of various forms of “corruption, waste and mismanagement” (Weir 1992, 126; Mucciaroni 1990). According to one observer, by the time it was discontinued, the CETA had almost become “a four letter word” in the public debate in the United States (Donahue 1989, 181).

The issue of legitimacy in the implementation process was also important for policymakers in Sweden when ALMP was launched. When creating its extensive and internationally well-known active labor market policy program in the 1940s and 1950s, the Swedish Social Democrats who then were in government paid meticulous attention to the questions of legitimacy in the implementation processes, using a large set of unorthodox administrative measures to protect the program against mismanagement and implementation hurdles (Rothstein 1996). Another example is the active labor market program in Germany. After the unification of Germany, active labor market programs in the former East Germany ran into problems be-

cause the case workers made the wrong predictions about what sorts of training the long term unemployed needed (Lechner, Miquel and Wunsch 2007). Simply put, empirical research show that in order to work properly, ALMP has to be a high quality product and since the policy by its very nature demands a high level of flexibility, discretion and adaption in the stage of implementation, this is a complicated matter (Lindvert 2006, Camfors, Forslund and Hemström 2004)

If the government is not the sole provider, if there is little or no bureaucratic discretion, or if accountability is easy to achieve, bureaucratic capacity should matter less. Since we have chosen cash benefits to families as our example of a non-discretionary program for purposes of statistical analysis, we can illustrate this point with the discussion that took place in the Social Democratic party in Sweden in the 1940s about how to organize support needy families with children. In brief, one approach, favored by the Alva and Gunnar Myrdal and termed the “in-kind line,” called for a selective targeting of assistance to families with children suffering from economic deprivation, and urged that such aid be distributed in the form of various goods. The needy mothers would receive clothing, shoes, vitamins, foodstuffs, etc., from municipal retail outlets. Moreover, the Myrdals suggested that the National Board of Social Affairs would see to the standardization of the quality of these goods. The argument for the in-kind line focused on the issues of targeting and quality. Means-testing would ensure that assistance went to the “truly needy,” and therefore also that maximum efficiency in the use of tax monies was achieved. The in-kind line made it possible, moreover, to guarantee that expenditures on behalf of needy families were converted into goods of the desired quality, for the consumption choices of recipients would be managed by experts (Rothstein 1998, ch. 8).

However, after an intense debate within the Social Democratic party, the selective, in-kind line lost out to the idea of universal, in-cash child benefits, which were introduced in 1948. The Minister of Social Affairs at that time, Gustav Möller, argued that the latter method would not only avoid the stigma associated with means-tests but also the many problems that would follow from bureaucratic discretion. The need for a large bureaucracy that would decide who would be eligible and how much support each such person should achieve would be

obviated. (Rothstein 1998, 178–179). Already in 1937, in his instructions to a large government investigation about support to families with children, Möller stated the following:

A characteristic feature of poor relief is that assistance is rendered after an open-ended means test, in which the authorities' subjective assessment of the individual's need for aid is determinative, both as regards the character of the assistance granted and its extent. Certainly, the first paragraph of the law on poor relief enjoins the municipalities to furnish minors and the disabled with the necessities of life, but in practice the municipal authorities enjoy very much a free hand in implementing this mandatory poor relief. ... During recent decades, however, a new type of social assistance has emerged, which in the respects mentioned differs from poor relief altogether. In area after area, arrangements have been undertaken, by means of state measures, which secure to citizens a right to the assistance of society, under certain conditions stated clearly in statute or in law, and comparatively easily ascertained. (These directives were issued upon the commissions' appointment in 1937. SOU 1942:56, 19.)

If one looks at these two types of family policy, it is obvious that the “in cash” line, contrary to the “in kind” line, handles the problem of monopoly provision since the parents can use the cash to buy whatever and wherever they deem necessary. Moreover, universal child allowances can be implemented without any bureaucratic discretion and the level of accountability is high (either the money is sent or not). The opposite holds true for the “in kind” line where local bureaucrats would have to decide what sort and how much utensils each family would be entailed to. Given the problems raised above about bureaucratic capacity, it is likely that when people consider whether “the government” should support families with children, they will take into account not only their ideological orientation about this issue, but also their perceptions of how well government authorities would implement the policy in question.

In sum, different types of policies vary in their sensitivity to the quality of the bureaucracy. Our argument is that the more a policy in its implementation is in need of case-by-case bureaucratic discretion, the more salient the problem of legitimacy in implementation process becomes. When it comes to more or less universal cash benefits, we have little reason to expect that citizens will pay attention to these problems. However, when it comes to policies that entail a lot of room for bureaucratic discretion, the issue of bureaucratic capacity should become more of a problem, since citizens will have to consider two questions: first the issue of substantive justice (is this a just policy or not?), and second the likelihood that their state, as they have come to know it, will be able to implement the policy in line with demands related to “procedural justice” (Levi 1998; Tyler 1998). Voters and their elected representatives may decide not to support policies that they would have liked to see enacted because they distrust their government’s capacity to implement them in an orderly and just way. This may be one reason for why, according to the ISSP survey mentioned above, the support in the United States for the idea “that the government should spend (much) more on old age pensions” is higher than it is in the Nordic countries (64 percent compared to 58.5 percent). This relatively strong support for universal cash benefits among U.S. citizens should be compared to the low level of support for the three other social policies mentioned above, which all entail considerable amounts of bureaucratic discretion in the implementation process.

## **Methods and Data**

Our selection of active labor market programs and family benefits as test cases for the theory is based on the following considerations. On the one hand, the main point of our theory is that there may be instances where some voters are in principle in favor of increased social spending (in some given policy area) but oppose increased spending since they are concerned with the efficiency and/or reliability of the bureaucracy. For this reason, we would like to concentrate on programs where there has been both a tendency to increase spending and a political rhetoric about the need for new spending. On the other hand, we are constrained by data availability when it comes to information about the reliability and efficiency of the bureaucracy. As we explain in the data section below, the only time-variant indicator that captures the dimensions of bureaucratic capacity that we are interested in is the Quality of Government mea-

sure developed by the organization PRS, in its International Country Risk Guide, and this data series begins in 1984. Ideally, we would therefore like to identify two programs for which there has been both a political rhetoric about the need for expansion *and* a tendency in many countries to increase spending in the period from the mid-1980s onwards. One of the programs should involve a great deal of bureaucratic discretion; the other should involve less.

Active labor market policies and family policies are good test cases, since they can be seen as responses to a complex of contemporary economic and social problems commonly referred to as *new social risks*. New social risks have resulted from labor market restructuring (such as the rise of the “post-industrial” service economy) and changing social norms and practices (such as increasing divorce rates and higher female labor force participation). As Bonoli (2005) has shown, new social risks tend to be concentrated among women, the young, and the low-skilled – all groups that we would expect to benefit from increased spending on active labor market policies and support for families. Moreover, whereas the main political discourse in other welfare state domains – such as pensions – has concerned retrenchment and reform, as opposed to expansion, in the period since the mid-1980s, political discourse about active labor market policies and family policies has concerned the need for expansion and new investments rather than cutbacks. Active labor market policies are promoted by international organizations such as the EU and the OECD as an important part of a policy package of “activation” (Weishaupt 2008). The family policy agenda has been equally prominent, and support for families via transfers and services has increased in most OECD countries in the 1980s, 1990s, and 2000s, as governments have responded to both declining fertility and social changes in divorce rates, family structures, and social norms concerning the work-family balance (Thévenon 2008).

Table 1 describes the development of spending on active labor market policies and cash benefits for families in the twenty-one countries in our sample. The table shows the first observation, the timing of the highest level of spending, and the most recent observation. In the (two) cases when there were several years with the highest levels of spending, the table shows the most recent observation. When it comes to ALMP spending, mean spending in our sample has increased from approximately 0.5 percent of GDP in the early 1980s to approximately 0.7 of

GDP in the early 2000s. As the table shows, ALMP spending has increased in thirteen countries, declined very slightly (by less than 0.1 percentage points) in six, and declined by more than 0.1 percentage points in only two countries. Almost all countries have experienced a period of significant growth in ALMP spending from the first observation (in most cases 1980 or 1985) to the highest level (in most cases some time in the 1990s). When it comes to cash benefits to families, mean spending in our sample has increased from approximately 1.25 percent of GDP in the early 1980s to approximately 1.35 of GDP in the early 2000s. As the table shows, spending on cash benefits for families has increased in eleven countries, declined very slightly (by less than 0.1 percentage points) in three, and declined by more than 0.1 percentage points in seven countries. In other words, in both cases, we observe a slight increase in average spending over time, as well as a lot of between-case variation that calls for an explanation.

[Table 1 about here]

The final criterion is how much bureaucratic discretion is involved at the implementation stage. It seems quite clear, as we discussed in the theory section, that ALMP involves a lot of discretion: all the programs in this spending category require individual bureaucrats to make discrete decisions involving large sums of money. Cash benefits to families are a very different matter: it is normally quite easy to establish whether someone is entitled to child benefits and it is relatively easy to establish if someone is entitled to parental leave benefits (and how much). In any event, the administration of ALMPs is clearly much more involved than the administration of family benefits.

### *Methodology*

We have data for 21 advanced industrialized countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States) over a period of between 14 (Austria, Italy, Japan) and 19 years (most of the other countries in the

sample) (the number of years per country decreases to between 7 and 18 in some specifications because of data limitations for important control variables).

We run separate regressions for the two policy areas, presenting a series of models with increasing numbers of control variables that have been identified in previous work on ALMPs and family policies (see below). There is a potential problem with this procedure. Since ALMP spending and family policy spending are both government programs, increased spending on one may presumably reduce spending on the other, and if this is a serious concern (see Breunig and Busemeyer 2009 for a methodological discussion of this problem), the statistical analysis should take this kind of mutual dependence into account. In our case, however, the two types of programs account for a relatively small proportion of the overall social policy budget (approximately 10 percent on average, ranging from 2 to 20 percent) and moreover, spending on ALMPs and cash benefits to families is positively correlated (the correlation between the two spending measures as a percentage of GDP is  $r = 0.26$ ), suggesting that increased spending on one does not reduce spending on the other.

We estimate the models with OLS, using panel-corrected standard errors in order to control for panel-level heteroskedasticity (Beck and Katz 1995). We introduce a lagged dependent variable since there is every reason to believe that last year's spending influences present spending. In some specifications we use fixed effects. Since the main independent variable, bureaucratic capacity, is slow-moving (the between-case variation is approximately twice as large as the within-case variation), we use a new estimator developed by Thomas Plümper and Vera Troeger (2007) for fixed effects models with non-variant or cross-sectionally dominated variables.

Another potential problem with budgetary data is that there is often reason to be concerned with non-stationarity, but in our case a Levin-Lin-Chu test for unit roots in panel data rejects the hypothesis that either the ALMP data series or the family benefits data series have a unit root (Levin, Lin, and Chu, 2002).

*Dependent Variables: Social Expenditure Data*

Public spending on the two programs we concentrate on – active labor market policies and cash benefits to families – are measured as a percentage of GDP, and the data are drawn from the OECD Social Expenditure Database (OECD 2007). There are well-known problems with using expenditure as an indicator of welfare state policies, but these problems do not apply to our study. The first potential problem is that measures of social expenditure as a percentage of GDP do not just pick up changes in policy but also changes in the societal problems that policies address, as well as changes in the denominator, GDP (Allan & Scruggs 2004; Clayton & Pontusson 1998; Korpi & Palme 2003). The second potential problem is that it is hard to see why political actors would be concerned with increasing expenditure *per se*. As Esping-Andersen has pointed out, actors normally have preferences over specific policy schemes and for protection against specific social risks, not for the level of public spending as such (Esping-Andersen 1990, 19).

We handle the first problem by including a set of control variables that account both for the specific economic and social pressures that are likely to influence spending in the two policy domains and for GDP output and growth (dealing with the denominator problem). The second and often more difficult objection is of less concern here. We agree with Esping-Andersen (1990) that in most circumstances expenditure data do not capture the policy preferences of political agents. However, the key mechanism of our theory is that voters and politicians in states with low bureaucratic capacity are concerned with the return (good policy outcomes) on their investment (taxes) – in that sense; the agents in our model are concerned with spending *per se*.

#### *Independent variable: The Quality of Government*

In order to evaluate our hypothesis we need to measure the reliability and efficiency of the state bureaucracy. As we have already mentioned, we rely on a composite measure of *Quality of Government* that is included in Political Risk Service's International Country Risk Guide. It is the mean value of three component variables, and it is scaled from 0 to 1. Higher values indicate more Quality of Government. The first component variable is a measure of corruption;



the second is a measure of law and order, while the third is a measure of the quality of the bureaucracy. Political Risk Services is a private, international organization that evaluates risks for investors in different countries, but its Quality of Government data have been used in a long series of scholarly articles, beginning with Knack and Keefer (1995). Even though it was originally designed to appraise risks for private investors, this measure actually fits our theoretical definition of bureaucratic efficiency and reliability very well: the situation that citizens and politicians face when they form preferences for specific social and labor market programs is fairly similar to that of private investors who consider investing in a country. As we have already discussed in the theory section, citizens and politicians ask themselves if a given program is likely to be implemented impartially and efficiently and thus if it is a good way to use the money of the taxpayers.

### *Control Variables*

There is no standard set of determinants of active labor market policies and family policies. To account for alternative explanations, we have therefore tested several alternative specifications. In order to identify the most relevant control variables the ALMP models mostly rely on Rueda (2006), Huo, Nelson and Stephens (2008), Iversen (2009), and Martin and Swank (2009), while the cash family benefit models mostly rely on Sainsbury (1996), Ferrarini (2006), Bratton and Ray (2002), Kaiser (1997) and Schwindt-Bayer and Mishler (2005). The controls can be divided into four groups: political variables, economic variables, labor market variables, and variables measuring the size of the recipient groups.

We include four political variables in the analysis. The first two are meant to capture the influence of left parties and Christian democratic parties, since a number of studies have found that left parties and Christian democratic parties are associated with higher welfare state ambitions but potentially different spending allocations (Esping-Andersen 1990; Huber & Stephens 2001; Korpi 1983). Some scholars claim that left government tends to increase spending on active labor market policies (Huo, Nelson and Stephens 2008; Iversen 2009), whereas others disagree (Rueda 2006). In the family policy domain, the influence of government partisanship is also debated, but the partisan composition of the government is normally included in

empirical analyses (Ferrarini 2006; Huber and Stephens 2000; Sainsbury 1996). The strength of left parties and Christian democratic parties is defined as the percentage of cabinet portfolios held by these two categories of parties (the data are from Duane Swank's Comparative Political Parties Dataset, Swank 2009).

The third political variable is the electoral system. It is clear that the proportionality of the electoral system affects coalition dynamics. Many scholars have also claimed that proportional representation makes the political system more responsive to new risks, or "shocks" (Iversen 2009). The fourth political variable – the level of female representation in the national Parliament – is only included in the family policy specifications. It is often hypothesized that a high level of female representation increases both family policy spending and the efficiency of its implementation (Keiser 1997). Female representation is measured as the percentage of women in the lower houses of national parliaments. Data originally comes from Melander (2005); we use the version provided in the QoG Social Policy Dataset (Samanni et. al. 2008).

As we have already mentioned, economic pressures on the programs are potentially very important. We include five economic variables in our analysis. GDP growth is included to control for business cycles, public debt is included to control for the government's fiscal room for maneuver, and openness to trade is included to capture economic interdependence. GDP is included to control for the level of economic development. Since there are strong reasons to believe that the effect of GDP is non-linear (low levels of GDP constrain welfare spending, which means that increases in GDP should increase the proportion of GDP that is used for social spending, but when a country has passed a certain threshold, increases in GDP are likely to increase the denominator more than the numerator), we also include a squared GDP term. The fifth economic variable, unemployment, is an indirect measure of the size of the group that benefits from active labor market policy, but unemployment also has a potential to explain family policy as persistent unemployment has the potential to hollow out tax base supporting all welfare state programs (Korpi & Palme 2003). Data on the economic variables come from Penn World Tables (GDP, growth, openness) and the OECD (debt, unemployment).

Our dataset includes three variables that describe national labor markets. First unions are likely to be interested in active labor market policies for at least two reasons: they want the state to invest in programs that can help their members to re-enter the labor market when unemployed, but they also want to ensure that active labor market programs do not crowd out ordinary employment (Rueda 2006). Union density is therefore included in the analysis of active labor market policies. The coordination of wage bargaining is used as a measurement of corporatism and included in the ALMP specifications, since corporatism has been shown to influence spending on active labor market policies (Martin & Swank 2009). Female labor force participation is included in the family policy specifications since higher female participation in the labor force is likely to increase demand for family policy programs (Ferraini 2006; Huber & Stephens 2000). The data on union density are from Jelle Visser (2009) and the data on female labor force participation are from the OECD.

Three additional variables are introduced in order to control for the size of the target groups of the two programs. The proportions of elderly and young in each country are introduced to control for the size of age groups with competing claims on welfare spending. The fertility rate is introduced in the family policy specifications in order to control directly for the size of the group of family policy beneficiaries. The population data are from the OECD and the fertility data are from the World Development Indicators.

## **Empirical Results**

Table 2 reports the main results of the statistical analysis. The models ALMP 1 and Family 1 are estimated with OLS using panel-corrected standard errors and a set of control variables common to both models. The models ALMP 2 and Family 2 also include a set of control variables that is specific to each type of program (labor market-related variables for ALMPs and variables measuring fertility, female political mobilization, and female labor force participation for family policies). The models ALMP 3 and Family 3 are identical to ALMP 2 and Family 2 but include country fixed effects. Since many of the explanatory variables in the two last models are slow-moving or cross-sectionally dominated, we estimate these models with the

Fixed Effects Vector Decomposition estimator proposed by Plümper and Troeger (2007). This estimator requires a distinction between variables that are slow moving (or cross-sectionally dominated) and variables that are not, and there are as yet no clear guidelines concerning appropriate cutoff points. We treat institutional variables such as the quality of government, PR, and wage bargaining coordination as invariant, as well as all variables for which the between-case standard deviation is much higher than the within-case standard deviation (openness, union density, public debt, and women in parliament).

[Table 2 about here]

The first observation that we can make on the basis of Table 2 is that the Quality of Government variable has very different effects on ALMP spending and spending on cash benefits to families. We can say with a high level of confidence that the Quality of Government has a positive and statistically significant effect on ALMP spending, but all coefficients for QoG in the models of cash benefits to families are negative, and the standard errors are large (compared to the coefficients) – the exception being the third family model, where the coefficient for QoG reaches standard levels of statistical significance. On balance, there is no reason to believe that QoG has any effect on family policy spending, just as our theoretical argument leads us to expect. In general, these results increase our confidence in the theoretical model that we have presented.

In dynamic panel data models with lagged dependent variables, the raw coefficients are not very informative. The coefficient for the QoG variable can be interpreted as the increase in ALMP spending in year 2 that results from an increase in the Quality of Government in year 1 from its theoretical minimum (0) to its theoretical maximum (1). A more substantively interesting figure is the long-term effect of a permanent increase in the Quality of Government within the range of values that can be observed in our sample. The sample minimum is 0.5 (Greece in 1985) and the sample maximum is 1 (most observations of Canada, Denmark, Finland, the Netherlands, Sweden, and Switzerland). Let us consider the long-run effect ( $t \rightarrow \infty$ ) of a permanent increase in the Quality of Government from the mean measure for Greece (0.689) to the mean measure for the Netherlands (0.996). Based on our models, we can calcu-

late the long run-effect of this (radical) change in the quality of government as follows: in model 1 the long run effect is 1.14, in model 2 it is 0.80, in model 3 it is 0.45.

These are large numbers, since the minimum value of ALMP spending per capita in the sample is 0 and the maximum value is 2.86 (moreover, more than 90 percent of the observations are in the 0–1.5 range). On the basis of this evidence, we conclude that the quality of the government bureaucracy is an important determinant of ALMP spending (a program that involves a great deal of discretionary power for individual bureaucrats), but not of spending on cash benefits for families (which involves less bureaucratic discretion).

Concerning the political control variables, we note that short-term changes in the party composition of governments do not appear to have consistent effects on spending in either policy area. The coefficients are small and change signs and the standard errors are relatively large across all the models that we present. As Martin and Swank (2009) point out in their analysis of active labor market policy, however, it may well be that partisan politics has an indirect long-term effect on both ALMP spending and family policies through other variables such as the Quality of Government, bargaining centralization, women in parliament, and union density. Thus, on the basis of our analysis we can only make claims about that lack of effects of short-term changes in government. The third political variable, the proportionality of the electoral system, has significant effects on both ALMP and family policy spending. Effects on ALMP spending are consistently negative, while the effects on family policy are positive.

Concerning the economic variables, the effects are similar to other analyses of the types of social spending data that we rely on, and are probably driven by the fact that GDP per capita is the denominator on the left hand side of the regression equation and included on the right hand side. We have no substantive interest in these coefficients: we simply wish to control for the effects of the business cycle on our measures of spending.

Unemployment appears to have a negative effect on family policy spending (probably because the increasing demands on employment programs reduce the room for spending in other policy domains) but if anything a positive effect on ALMP spending (which is not unexpect-

ed, since rising unemployment means that the target population for ALMPs increases in volume – in fact, it is rather surprising that we cannot infer that this effect actually exists). When it comes to debt, this variable has, if anything, the expected negative effect, although only two of the estimates (for family policy) are statistically significant.

Concerning the control variables that are specific to the ALMP model, our analysis gives some support to the compensation hypothesis: open economies are associated with more spending on ALMPs, and the effect in ALMP model 3 is statistically significant. What is more, both unionization and wage bargaining centralization are associated with higher levels of ALMP spending, a result that is consistent with the work of Martin and Swank (2004, 2009) on the effects of labor market coordination on ALMP spending.

Concerning the control variables that are specific to the family policy model, we expect female representation to have a positive effect on spending (Ferrarini 2006; Keiser 1997; Bratton and Ray 2003; Wängnerud 2009). The estimates in family model 3 are compatible with this expectation: the political mobilization of women seems to matter to spending on cash benefits to families. There is also some evidence that the fertility rate (which is a measure of the target population of family policies) increases the level of family policy spending. These effects are, however not consistently statistically significant. One reason for an underestimation of positive effects of female labor force participation could be that this effect to a large extent goes through female representation in the legislature, since it is likely that female labor force participation contribute to high levels of female representation (Iversen and Rosenbluth 2008). The effect of female labor force participation could therefore also be captured by the variable women in parliament discussed above.

We have re-estimated our original models eliminating one country at a time from the sample, in order to see whether the conclusions are influenced by any particular country-level observations. To do so we use so-called “jackknifed” estimates that are often used in comparative analysis with relatively few countries (see for example Martin & Swank, 2008). To compute the “jackknifed” estimates we calculate 21 20-country equations. The mean of the 21 new coefficients becomes the “jackknifed” coefficient for the variable and the mean standard errors

of these 21 20-country estimates becomes the standard error. This exercise shows that the coefficient for Quality of Government indicator stays statistically significant in the “jackknifed” ALMP models, and the magnitudes of the effects of the Quality of Government indicator are similar. Turning to the family policy models, the Quality of Government indicator remains statistically insignificant. Again, the magnitudes of the effects are the same. Consequently, we are reasonably confident that the Quality of Government influences ALMP spending, but not spending on cash benefits to families.

As an additional robustness check, we have excluded one particular variable that constrain data availability: public debt. We have re-estimated our models without this control variable, to see how a reduced model performs in a larger sample. The results remain similar, although the QoG coefficient declines to 0.19 in the first, 0.19 in the second and 0.36 in the third model (using different estimators), staying significant at the 0.01 and 0.05 levels.

## **Conclusions**

This paper has suggested that the national bureaucracy’s capacity to implement social and labor market programs in an efficient and reliable manner affects the policy choices of voters and politicians. We have argued that policymakers are likely to be reluctant to invest large sums of public money in policy programs that require bureaucratic discretion if the national bureaucracy’s capacity can be called into question. We believe that this is a very important and often ignored explanation for the variation in social and labor market policies across advanced economies.

Although most social and labor market programs require a competent and reliable bureaucracy, there is a large variation in how much different programs rely on bureaucratic discretion. The theory in this paper leads us to expect the bureaucratic capacity to influence spending on programs that require bureaucratic discretion, while a similar effect should not be found on spending on programs that require less bureaucratic discretion. Consequently, for the empirical test in this paper we identify one program that is difficult to implement, and accordingly involves more bureaucratic discretion (active labor market policy), and one program that only

depends on cash transfers and thus involves less bureaucratic discretion (cash benefits to families).

Our analysis of the two programs involve spending data from 21 advanced industrialized countries between 1985 and 2003. The empirical results confirm the theoretical expectations. Even when we control for a broad set of alternative explanations, we can report a consistent and positive effect of the quality of the bureaucracy on active labor market spending, but no such effect on cash benefits to families.

The theoretical arguments and empirical results discussed in this paper show that the bureaucracy matters to policymaking. This insight is too often forgotten in contemporary comparative studies of social and labor market policy. As Hugh Heclo argued long ago (1974), policymaking is not only driven by the strength of different political groups but also by the functioning of the state itself. The legitimacy (or lack of legitimacy) that is generated on the output side of government has important effects on policy, since politicians only choose from policies that can be delivered by the national bureaucracy.



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## Tables

**Table 1**

**Active Labor Market Policies and Family Benefits (as a Percentage of GDP).**

	Spending on Active Labor Market Policy			Spending on Cash Benefits for Families		
	Earliest	Highest	Latest	Earliest	Highest	Latest
Australia	0.40 (1985)	0.79 (1995)	0.38 (2003)	0.95 (1981)	2.65 (2003)	2.65 (2003)
Austria	0.27 (1985)	0.62 (2003)	0.62 (2003)	2.52 (1985)	2.88 (1994)	2.50 (2003)
Belgium	1.27 (1985)	1.42 (1996)	1.21 (2003)	2.90 (1981)	2.90 (1981)	1.74 (2003)
Canada	0.29 (1980)	0.65 (1985)	0.37 (2003)	0.64 (1981)	0.91 (2003)	0.91 (2003)
Denmark	0.43 (1980)	1.87 (1995)	1.62 (2003)	1.03 (1981)	1.84 (1995)	1.62 (2003)
Finland	0.98 (1980)	1.75 (1992)	0.91 (2003)	1.08 (1981)	2.88 (1994)	1.59 (2003)
France	0.64 (1985)	1.37 (1999)	1.07 (2003)	2.47 (1981)	2.47 (1981)	1.45 (2003)
Germany	0.70 (1985)	1.82 (1992)	1.12 (2003)	1.86 (1981)	1.86 (1981)	1.17 (2003)
Greece	0.17 (1985)	0.40 (1991)	0.20 (2003)	0.48 (1981)	0.85 (1995)	0.85 (2003)
Ireland	1.45 (1985)	1.61 (1995)	0.68 (2003)	1.11 (1981)	2.27 (2003)	2.27 (2003)
Italy	0.23 (1990)	0.67 (2003)	0.67 (2003)	1.17 (1981)	1.17 (1981)	0.59 (2003)
Japan	0.31 (1990)	0.32 (1996)	0.30 (2003)	0.24 (1981)	0.30 (2003)	0.30 (2003)
Netherlands	0.55 (1980)	1.28 (2001)	1.06 (2003)	1.86 (1981)	1.86 (1981)	0.75 (2003)
N. Zealand	0.58 (1980)	1.05 (1992)	0.44 (2003)	1.94 (1981)	2.62 (1989)	1.89 (2003)
Norway	0.61 (1985)	1.33 (1994)	0.80 (2003)	1.32 (1985)	2.33 (1994)	1.91 (2003)
Portugal	0.34 (1986)	0.84 (1996)	0.71 (2003)	0.80 (1981)	0.80 (1981)	0.73 (2003)
Spain	0.18 (1980)	0.89 (2000)	0.68 (2003)	0.38 (1981)	0.39 (2003)	0.39 (2003)
Sweden	1.20 (1980)	2.86 (1994)	1.27 (2003)	1.73 (1981)	2.49 (1992)	1.60 (2003)
Switzerland	0.07 (1980)	0.77 (1998)	0.72 (2003)	1.00 (1981)	1.10 (1997)	1.06 (2003)
U. Kingdom	0.56 (1980)	0.86 (1987)	0.51 (2003)	1.91 (1981)	2.18 (2003)	2.18 (2003)
U. States	0.16 (1980)	0.27 (1986)	0.14 (2003)	0.43 (1981)	0.43 (1981)	0.09 (2003)

**Table 2****Main Results**

	ALMP 1	ALMP 2	ALMP 3	Family 1	Family 2	Family 3
Quality of Government <sub>t-1</sub> (0–1)	0.227*** (0.069)	0.238*** (0.078)	0.382*** (0.055)	-0.111 (0.079)	-0.0935 (0.098)	-0.121* (0.070)
ALMP Spending <sub>t-1</sub> (Percentage of GDP)	0.939*** (0.018)	0.909*** (0.020)	0.739*** (0.046)			
Family Benefits Spending <sub>t-1</sub> (Percentage of GDP)				0.994*** (0.009)	0.984*** (0.011)	0.836*** (0.033)
Proportional Representation (0–1)	-0.000 (0.009)	-0.074*** (0.015)	-0.071*** (0.017)	0.056*** (0.014)	0.086*** (0.020)	0.042*** (0.008)
Left Government (0–1)	0.007 (0.016)	-0.002 (0.016)	-0.030 (0.020)	-0.029* (0.016)	-0.016 (0.018)	-0.035* (0.019)
Christian Democratic Government (0–1)	0.046* (0.025)	0.031 (0.026)	-0.038 (0.038)	-0.0881*** (0.020)	-0.0583** (0.028)	0.0346 (0.034)
Unemployment <sub>t-1</sub> (0–1)	0.150 (0.214)	0.268 (0.199)	0.731 (0.461)	-0.225 (0.147)	-0.098 (0.171)	-0.707** (0.349)
Real GDP per Capita <sub>t-1</sub> (Constant U.S. Dollars)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
Real GDP per Capita <sub>t-1</sub> <sup>2</sup> (Constant U.S. Dollars)	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000* (0.000)	-0.000** (0.000)
GDP Growth (Percent)	-0.014*** (0.003)	-0.015*** (0.003)	-0.012*** (0.003)	-0.008*** (0.003)	-0.010*** (0.003)	-0.010*** (0.003)
Debt <sub>t-1</sub> (0–1)	-0.008 (0.016)	-0.031** (0.016)	-0.010 (0.017)	-0.085*** (0.019)	-0.077*** (0.017)	-0.045*** (0.016)
Openness (Proportion of GDP, 0–1)		0.012 (0.024)	0.064*** (0.022)			
Union Density (0–1)		0.076 (0.047)	0.308*** (0.050)			
Bargaining Coordination (1–5)		0.030*** (0.007)	0.031*** (0.007)			
Women in Parliament (0–1)					-0.104 (0.123)	0.205** (0.085)
Fertility Rate <sub>t-1</sub>					0.066* (0.035)	0.056 (0.066)
Female Labor Force Participation <sub>t-1</sub> (0–1)					0.076 (0.101)	0.546** (0.249)
R2	0.934	0.937	0.945	0.976	0.976	0.981
N	321	321	321	334	312	312

Standard errors in parentheses

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$