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The political economy of activation.  
Explaining cross-national variation  
in active labour market policy

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### *Abstract*

The question of why OECD countries are turning to active labour market policy in rather different ways has recently attracted substantial attention by the comparative social policy research community. However, we seem to be far from a satisfactory account of the determinants of active labour market policy. This is shown by the conflicting findings published recently by Huo et al. (2008) who argue that left power is one of the key determinants of the development of active labour market policy, and Rueda (2007) who claims that left power is either irrelevant or negatively related to this trend. Using statistical analysis this paper contributes to this debate. It tests several hypotheses, including left power, the role of the trade unions, the role of labour market institutions, and the role of competing expenditure. It concludes that the strength of the left matters, but in conjunction with economic openness. It also argues that the expansion of ALMPs is currently limited by spending commitments in other areas of the welfare state.

## **Introduction**

Active labour market policies (ALMPs) are an important area of social policy making. Over the last decade, an active approach to labour market policy has been promoted by international agencies and adopted in several OECD countries. These developments have impacted on the funds that are assigned to active policies. Among OECD countries, between 1980 and 2003 the proportion of GDP invested in this field has nearly doubled, going from 0.4 to 0.7 of GDP. While increase in ALMP spending has been a general trend, massive cross national differences persist. In 2003, for instance, spending ranged between 0.2 % of GDP (USA) and 1.6% Denmark.

Extreme levels of cross-national variation are not the only puzzle one encounters when studying ALMPs, though. One key question that remains unsolved is whether Social democratic power is associated with more or less emphasis on ALMPs. This puzzle has been highlighted by two recent studies that deal precisely with this issue, use the same data, different methods, and reach opposite conclusions. According to Jingjing Huo and his colleagues, Social democratic power is a key factor in the expansion of ALMPs (Huo et al., 2008). The opposite view is defended by David Rueda, who claims that as a result of recent socioeconomic transformations, Social democrats are now under pressure to oppose ALMPs, and expects no clear effect of Social democratic power.

Using quantitative data and statistical modelling, this paper seeks to shed light on this unresolved puzzle. More generally, it contributes to understand what economic, political and institutional conditions are more likely to lead to the

development of ALMPs. My claim is that Social democratic power does matter for the expansion of ALMPs, but only in the context of an economically open economy. Powerful Social democrats are likely to fight for policies that improve the quality of life of their key constituency: waged-workers. Instinctively, they will tend to turn quick and direct improvements, through employment protection, decommodification and early retirement. However, in the context of an internationally exposed economy, these policies will not be a viable option because they would excessively penalise national producers. Powerful Social democratic parties in open economies will be caught under two contrasting pressures: further the interests of wage earners and preserve the competitiveness of national producers. ALMPs allow them to do this.

The development ALMPs is also likely to be affected by policy feedback effects that pertain to decisions taken in other fields of the welfare state. Today there is a clear consensus in favour of investment in ALMPs, but for countries that are grappling with the issue of financing the existing social programmes in the context of an ageing population, it will be difficult to free up the funds needed to set up a well functioning system of ALMPs. As a result, one can hypothesise a negative relationship between the amounts spent on traditional social policies, most notably old age pensions, and the expansion of ALMPs. The implication is that countries that started developing ALMPs earlier, before the rise of concerns for the financial stability of pension system, had an advantage relative to those who turn to these policies in the 2000s. If this hypothesis is correct, what we may witness is the crowding out of social spending on programmes other than those which are age- related.

The paper begins with a descriptive account of activation across OECD countries. It then moves on to discuss theoretical propositions that ambition to account for the observed variation. Next comes the statistical analysis and the results, which are discussed in the final section.

## Mapping cross-national variation in active labour market policy

The standard approach used by social policy researchers to measure the extent of development of a policy, is to look at how much is spent on it as a proportion of GDP. The approach, that will be followed here has been rightly criticised<sup>1</sup>, but it remains one of the most efficient ways to summarise complex information regarding a policy domain. One should nonetheless be aware the problems involved.

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<sup>1</sup> See e.g. Esping-Andersen, G. (1990) *The Three Worlds of Welfare Capitalism*, Cambridge, Polity Press, Siegel, N. A. (2000) *Jenseits der Expansion? Sozialpolitik in westlichen Demokratien 1975-95*. IN Schmidt, M. G. (Ed.) *Wohlfahrtsstaatliche Politik. Institutionen, politischer Prozesse und Leistungsprofil*. Opladen, Leske und Budrich.

Academic discussions of activation have shown the difficulties involved in defining the development of active labour market policies simply in terms of expansion of the welfare state (Clasen, 2000, Torfing, 1999) + Lodemel and Trickey). In some cases, activation can be implemented through stronger incentives or sanctions for rejecting job offers. These measures do not necessarily entail higher spending, and do not show up in expenditure figures. On the contrary, they may result in lower outlays, if they are based on benefit reductions. At the other extreme, policies that are classified as “active”, may simply be based on providing alternatives to market employment, de facto removing unemployed people from the workforce. Since these programmes tend to be costly, a focus on spending will overestimate the extent of activation that goes on in countries that have relied on these instruments, such as France. One should keep these problems in mind when looking at the figures presented here.

An additional problem one encounters when assessing comparatively the degree of development of active labour market policy is the partly automatic relationship between the rate of unemployment and the level of spending on these policies. Increases in the number of unemployed people will, *ceteris paribus*, result in higher spending on ALMPs, at least to the extent that funds are available to finance additional participation to the various relevant programmes. This automatic link between unemployment and ALMP spending may distort the picture one gets when looking only at spending as a percent of GDP. For this reason, table 1 provides also an unemployment weighted measure of ALMPs spending, consisting simply in the original figure (provided in the first column) divided by the unemployment rate. This correction assumes a linear relationship between the unemployment rate and spending, which may not reflect reality well. In fact, as the unemployment rate goes up during a recession, spending on ALMPs may well reach budget limits and stop growing, which would make the relationship look curvilinear (inverted quadratic). This shortcoming does not constitute too a serious problem for the present descriptive analysis, but may impact on the results obtained through statistical modelling. That's why the issue is brought up again in the section of methods.

The picture emerging from table 3.1. is quite clear. The Nordic welfare states are by far the most involved in active labour market policies, regardless of the measurement used. On average, in 2003 they spent 0.2 % of GDP per percentage point of unemployment on these programmes. Continental European welfare states spent a lower 0.15% for the same level of unemployment. The Netherlands constitute an outlier among this group of countries, as its expenditure levels are more in line with those found in Northern Europe. Finally, English speaking and Southern European countries are those who spend the least on ALMPs. The unemployment weighted figure is similar between the two groups (0.08 and 0.07 % of GDP per percentage point of unemployment). No clear outlier can be identified in either of these two groups.

Given the tradition of Social democratic dominance and the high levels ALMP spending in the Nordic countries, intuitively, one would probably go along the view that ALMPs, at least the costly variant, are an inherently left wing policy. Existing research and this paper show that things are more complicated.

Table 1. Spending on active labour market policies (2003)

	Spending on ALMPs as a percent of GDP	Spending on ALMPs as a percent of GDP per percentage point of unemployment
Denmark	1.62	0.30
Finland	0.91	0.10
Norway	0.80	0.18
Sweden	1.27	0.23
<i>Unweighted average Nordic</i>	<i>1.15</i>	<i>0.20</i>
Austria	0.62	0.15
Belgium	1.21	0.15
France	1.10	0.12
Germany	1.12	0.12
Luxembourg	0.26	0.07
Netherlands	1.06	0.29
Switzerland	0.72	0.17
<i>Unweighted average Continental</i>	<i>0.87</i>	<i>0.15</i>
Australia	0.38	0.06
Canada	0.37	0.05
New Zealand	0.44	0.10
Ireland	0.68	0.14
United Kingdom	0.51	0.10
United States	0.14	0.02
<i>Unweighted average English speaking</i>	<i>0.42</i>	<i>0.08</i>
Greece	0.20	0.02
Italy	0.67	0.08
Portugal	0.71	0.11
Spain	0.68	0.06
<i>Unweighted average Southern</i>	<i>0.57</i>	<i>0.07</i>
<i>Unweighted average (above countries)</i>	<i>0.74</i>	<i>0.12</i>

Source: SOCX (OECD, 2007);

## Literature and hypotheses

### ***Partisan effects: Left power and Christian democracy***

In Esping-Andersen's account of the development of different worlds of "welfare capitalism" emphasis on ALMPs is considered to be one of the defining feature of the "Social democratic" welfare regime. The power resources of the left allowed the labour movement to impose a costly but effective system of labour market policies, capable of securing full employment in the context of a rapidly changing economic structure (Esping-Andersen 1990: 167-168; Huber and Stephens 2001: 184).

This view is confirmed in the quantitative analysis of Huo et al (2008) who find Left power to be positively and significantly related to spending on ALMPs. Theoretically they expect the Left to favour ALMPs on two grounds. First, Social democrats have a preference for full employment, and ALMPs can contribute to this end. Second, ALMPs are a superior way to passive benefits in guaranteeing wage-earners welfare. In their own words:

The value of employment based human development, as a form of long-term insurance against social risk, serves to highlight the limitation of decommodification as a fundamental objective of social protection (Huo et al. 2008).

Social democratic parties, in sum, have promoted "employment friendly" labour market policies. In the respect they differ from Christian democrats, who have intervened in the field of employment by protecting jobs and by facilitating early retirement. Christian democracy, in their words, "continues to have difficulty reconciling labour market activation and the principle that 'labour is not a commodity'" (Huo et al. 2008: 17-8).

An alternative hypothesis is also possible. Christian democracy may also be associated with higher levels of spending on ALMPs, but these will not be so much geared towards promoting participation into market employment. Its main objective, instead, would be to provide an alternative to market employment. With reference to Esping-Andersen regime typology, these ALMPs could be termed "conservative ALMPs". Conservative ALMPs would be perfectly compatible with the key orientation in employment policy adopted in these countries, the so called labour reduction route. By removing participants from market employment in the medium/long term, these programmes are more akin to other labour reducing measures (such as early retirement) than to activation policies in the proper sense. These policies are costly, also because beneficiaries tend to remain longer in the programme. As a result they will generate higher expenditure on ALMPs. From a theoretical point of view it

is thus difficult to make a clear hypothesis with regard to the link between Christian democracy and spending on ALMPs. The result of these two contradictory effects may be the absence of any significant association. Alternatively, one or the other effect may prevail, resulting in a positive or in a negative relationship.

Partisan effects on ALMP spending are at the centre of another recent study, which challenges the view that Left power is associated with high ALMP spending. In it, David Rueda develops a more complex view of Social democrats' relationship with ALMPs. First, he argues, Social democrats in postindustrial societies are increasingly confronted with a dilemma. Recent socio-economic transformations have split the potential clientele of Social democrats into two groups, insiders and outsiders. Insiders constitute the traditional constituency of Social democracy: manual workers, low to middle paid wage earners, public sector workers, etc. Outsiders are those who are experiencing disadvantage: unemployed people, atypical workers, excluded people. Social democratic parties can theoretically cater for both clienteles, but sometimes the interests of one group clash with those of the other one. Under these circumstances, Social democrats will tend to defend the interest of insiders, better organised and more likely to respond with electoral support than outsiders (Rueda, 2007).

This is the case with active labour market policies. Rueda believes that these policies are in the interest of outsiders, because they facilitate the re-entry into employment, but they are detrimental to insiders, for two reasons. First, insiders being protected by employment protection legislation against the unemployment risk, they are unlikely to see the point in co-financing these policies as tax payers. Second, ALMPs stimulate labour supply and may create competition for (scarce) jobs or downwards pressures on wages. As a result, Social democratic parties are unlikely to support these policies. In his own words:

“ALMPs are designed to promote entry into the labour market of outsiders who will underbid insiders' wage demands. Since insiders are the core constituency of social democratic parties, my argument implies the absence of any government partisanship effects on ALMPs” (Rueda 2007: 74).

This claim is confirmed in Rueda's statistical analyses, where Left power as a predictor of ALMP spending is either not significant or even negative (see p. 92).

Things are likely to be different, however, in countries which are not experiencing a strong insider/outsider cleavage. In these countries it will be easier for Social democratic parties to simultaneously serve the interest of both insiders and outsiders. Insiders being less well protected, they are also exposed to the unemployment risk and thus likely to support ALMPs. In sum, Rueda expects

Left power to have a positive effect on ALMPs in low employment protection countries, and a negative one in high employment protection countries. He tests his hypothesis with pooled time series regression models in which he includes an interaction term Social democracy \* Employment protection legislation which is indeed negatively related to spending on ALMPs (Rueda 2007: 95).

The contrast between the findings of the studies by Huo *et al.* and Rueda is striking. The data sources they use are the same. They use different model specifications and regression techniques, though. They also use different methods to control for variation in the unemployment rate. These methodological issues are discussed below.

### ***Cross-class coalition***

Some commentators have challenged the “power resources” view that in the Nordic countries ALMPs were imposed by powerful labour movements upon reluctant employers. Instead, they claim, the Nordic, and in particular the Swedish version of active labour market policy, was part of a major cross-class compromise that allowed Social democrats to pursue their political objectives without endangering the profitability of capital (Katzenstein, 1985, Swenson, 2002). According to Peter Swenson:

“[Swedish] Employers warmly endorsed activist training and mobility measures even before the labor confederation included them as the centerpiece of their plan for economic stabilization and industrial development. ... Organized employers were not merely resigned to hegemonic Social Democrats and hoping to appease them for special consideration on particular details, for nicer treatment in other domains, or to avoid public disfavour” (Swenson 2002: 11).

ALMPs, unlike the passive income protection policies, have what it takes to be regarded positively by employers. Having workers equipped with up-to-date skills and promoting labour supply are objectives to which most employers can subscribe.

The claim that ALMPs are the result of a cross-class compromise can be useful in generating hypothesis that go beyond the Nordic countries. If we accept the view that ALMPs are a form of labour market intervention that has positive effects for both employers and employees, then the puzzle is why such win-win solutions to employment problems were not adopted more generally throughout western Europe. Why did countries like France, Germany or Italy in the 1970s turn to employment protection and labour supply reducing policies instead of ALMPs? The literature on democratic corporatism provides a lead here (Katzenstein, 1985). Large continental European countries felt less under pressure from the international economic context. The left, and through a well



documented process known as of “contagion from the left” centre parties as well, felt capable of overcoming employers resistance against their policies (Volkens, 2004). The situation was different in the small and open economies of northern Europe. Up there, exposure to international economic pressures prevented the Social democrats from using more draconian measures to deal with labour market problems. The strong unions and the Social democratic parties of northern Europe would most probably have had enough political power to impose secure employment contracts and a gradual reduction in the age of retirement. But these solutions, unlike ALMPs hit directly employers’ competitiveness.

Some authors have pointed out that under some circumstances, employer protection may also be beneficial to employers (Estevez-Abe et al., 2001). In “coordinated market economies” where production is based on industry specific skills, protecting workers’ jobs encourages them to invest in the (necessary) skills. It also reduces labour turnover which makes the risk of losing workers in whose skills employers have invested, smaller. While this view may make some theoretical sense, it ignores a number of established empirical observations. First, the strong opposition to any form of employment protection legislation voiced by employers regardless of the production regime in which they operate. Second, the fact that the countries that have mostly turned to employment protection as a tool to deal with the employment crisis of the 1970s are not those that are typically classified as “coordinated market economies”. EPL is typically strongest in southern European countries, which are particularly difficult to classify in the coordinated vs. liberal market economies framework. They are sometimes referred to as mixed-economies in this literature (Iversen and Stephens, 2008) .

### ***Strong left in international economies***

On the basis of the above discussion, one can hypothesise the existence of an interaction between a strong left and the degree of economic internationalisation. Strong left parties, wherever they are, are subjected to strong rank-and-file pressures to adopt pro-worker policies. If they are acting in the context of a relatively closed economy, they may go for employment protection and early retirement. These are policies that are clearly beneficial to wage-earners, as they respond to their aspirations to economic security and rest in old age. However, if a strong left acts in the context of an open economy, these policy options will be off the menu, because they would be too detrimental to the competitiveness of the national producers. It is worth noting that this hypothesis finds confirmation in both the studies of Rueda and Huo et al., who find a negative correlation between trade openness and the strictness of EPL<sup>2</sup>.

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<sup>2</sup> Rueda finds a moderately significant negative relationship (Rueda 2007 : 89 ; Huo et al. find a strongly significant negative relationship (Huo et al. 2008: 16).

A strong left in an open economy will be caught in a dilemma: it will be pressurised into defending workers' interests by its supporters, but at the same time it won't be able to rely on the traditional pro-worker policies, because these may have ruinous economic consequences. Active labour market policies represent the elegant way out of this dilemma.

This hypothesis is also compatible with two empirically established developments. First the early introduction of ALMPs in the Nordic countries, which present precisely this combination of a strong left in an open economy that are expected to be conducive to active labour market policy. Second, the move towards ALMPs that has taken place since the mid- 1990s, often under left-of-centre government acting in the context of increasingly open economies.

### ***Competing claims and crowding out***

Institutional explanations often focus on feedback effects: new policies are the consequence of (unintended) effects of older policies (Pierson, 1993). In the context of welfare state adaptation, one can hypothesise the existence of a feedback effect originating in spending on traditional social programmes and constraining the opportunities to develop or expand new ones. In other words, one can expect countries that are confronting serious financial problems in guaranteeing the promises made during the postwar years, essentially through the pension system, to be less inclined to develop new policies. In these countries coverage against new social risks, such as prolonged exclusion from employment, will remain low or inexistent. In short, high spending on traditional programmes impedes the development of new ones. I term this effect "crowding out".

This hypothesis requires a longitudinal discussion. In fact, high levels of spending on traditional programmes are related to two variables: the generosity of such programmes and the age structure of the population. Since spending on traditional programmes tends to be strongly related to age, an older demographic structure will, *ceteris paribus*, translate into higher spending and stronger crowding out effects. This hypothesis needs to be studied longitudinally because as the population of OECD countries ages, the configuration of the two relevant independent variables changes. In the 1970s, a relatively favourable demographic structure, even if coupled with a generous pension system, would not have produced a strong crowding-out effect. Instead, the same pension rules may de facto crowd-out spending on other programmes if the size of the older population is substantial and growing.

The implicit presence of a longitudinal dimension in the crowding-out hypothesis suggests that "time matters" in so far as the opportunities to expand new social policies, ALMPs being one of them, are concerned. As argued in qualitative studies, countries where pressures to develop new policies emerge rela-

tively early (in the 1970s) can more easily set up comprehensive systems of activation because spending on this new policy does not face strong competition (yet) from spending on old age pensions (Bonoli, 2007, Fargion, 2000). In contrast, countries where pressures appear first in the 1990s or in the 2000s face considerably bigger difficulties, because for a large number of voters the key budgetary priority is not the expansion of services but is the preservation of the current generous pension system. This hypothesis helps us understand the divergence between the Nordic countries on the one hand and Continental and southern Europe on the other. Quantitative evidence linking the timing of key developments to spending on ALMPs and other new social policies confirms this hypothesis (Bonoli, 2007).

Of course it is not timing per se that causes more or less spending on ALMPs. Rather, it is the configuration of two independent variables (population age structure and pension generosity) that changes across time, and may or may not produce the kind of crowding-out effect described above. Since the configuration of independent variables is expected to vary across time and space, this hypothesis can fruitfully be examined with a pooled time series research design.

### ***Diffusion of policy ideas***

Over the last two decades, active labour market policies have spread across OECD countries suggesting that some diffusion process may be going on. Of the various diffusion mechanisms that are mentioned in the literature, learning seems the most adequate to account for the success of ALMPs (Braun and Gilardi, 2006, Hall, 1993). Countries facing mass unemployment may find a source of inspiration in promising experiences carried out elsewhere.

Qualitative studies lend support to the policy diffusion hypothesis. They have shown that governments looking for new solutions to the unemployment problem have studied and learned from experiences done elsewhere. In Germany, the reorientation of unemployment policy decided in 2002, was after having commissioned studies on and organised fact finding missions in countries like Denmark, The Netherlands and in the UK. Various elements of the new arrangement are clearly reminiscent of the UK approach to activation (Seeleib-Kaiser and Fleckenstein, 2007). The UK, in turn, is said to have found its inspiration in the US Clinton reforms of the early 1990s. Other studies have emphasised the role played by international agencies such as the OECD and the EU, who since the mid-1990s have clearly promoted a reorientation of unemployment policy in the direction of activation (Armingeon, 2007, Armingeon and Beyeler, 2004).

Efforts in this direction have been particularly strong within the European Employment Strategy (Goetschy, 2001, Zeitlin and Pochet, 2005, de la Porte and Nanz, 2003). Interviews with policy-makers show clearly that in the field of

employment policy, countries are learning from one another and that the process is sped up the European Employment strategy (Lopez-Santana, 2006).

That policy diffusion has played an important role in the spread of ALMPs across OECD countries is a plausible proposition. However, this thesis lends itself more to investigation by qualitative methods. Some authors are trying to adapt statistical methods to the analysis of diffusion mechanisms, but the methodological problems they encounter are such that a qualitative approach still yields more convincing results. Since this paper relies on quantitative methods, this hypothesis will not be pursued further.

### ***Data and methods***

As it is often the case with statistical analysis, the hypotheses that can actually be tested are heavily dependent on data availability. This paper is no exception, which means that it will only be possible to test some of the hypotheses presented above. Of course this does not mean that the remaining hypotheses are irrelevant. This is certainly the case of the policy diffusion hypothesis. The cross-class coalition hypothesis cannot be directly tested with quantitative methods. However, it is indirectly related with the hypothesis left power in an open economy. The idea behind this hypothesis is precisely the fact that economic openness and a strong left are conducive to a cross-class compromise consisting of strong emphasis on ALMPs. As a result, empirical confirmation of the “strong left in an open economy” hypothesis can be interpreted as support for Swenson’s cross-class coalition thesis.

The analysis relies on data on 21 OECD countries that have been democratic since the 1980s, between 1980 and 2003. Former communist and other new members of the OECD are excluded, because the political and labour market dynamics are arguably different in these contexts. Are also excluded from the analysis Iceland and Luxembourg. With regard to the former, data is missing for most of the period covered. Luxembourg has been excluded because it is a rather particular case in relation to both its labour market and its position in the international economy. Luxembourg does not have an unemployment problem (the unemployment rate is always below 3% throughout the period covered, except in one year). In addition, the measurement of economic openness for Luxembourg is vastly overestimated because many import/export companies are based in that country. The trade openness indicator is artificially pushed up by imports that are immediately re-exported<sup>3</sup>.

### ***Dependent variable***

The objective of this paper is to account for cross-national variation in the effort different countries make in the field of active labour market policy. The most straightforward way to measure this is to use spending on ALMPs. In

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<sup>3</sup> The sum of import and export amounted to 256% of GDP in 2003.

comparison to other programmes, however, expenditure on ALMPs is rather volatile, being directly affected by fluctuations of the unemployment rate. An increase in the number of jobless may cause expenditure to rise simply because there are more beneficiaries to these programmes. Such an increase should not be mistaken for an expansion of the policy.

There are a number of different ways to suppress this unwanted effect. The simplest way is to include the rate of unemployment on the right-side of the equation as a control variable. The other coefficients can then be interpreted as effects at constant unemployment rate. This is the approach used in Rueda 2007. Alternatively, one can standardise the dependent variable simply by dividing it by the rate of unemployment. In this case, the new dependent variable will be a measure of spending on ALMPs per percentage point of unemployment. This is the approach followed by Huo et al. 2008.

The problem of whether to use ratios or controls when dealing with the question of how to suppress an unwanted effect has been encountered in the natural sciences as well. The consensus emerging from the literature is that if the objective of the researcher is to explain the absolute size of something, then the control should be used. Ratios should be used only if the objective is to explain the proportion of something relative to something else (Bollen and Ward, 1979, Smith, 2005). In the case of ALMPs, a ratio would make sense if the dependent variable were spending on active labour market policies as a proportion of total spending for unemployment. This ratio would have a meaningful interpretation, showing the active or passive bias of policy. If the objective is instead to control for unemployment, then the inclusion of the unemployment rate on the right side of the regression equation is the appropriate strategy. This is the approach followed in this paper.

### ***Independent variables***

Since my aim is to uncover casual relationship, all independent variables are lagged by one year.

*Partisan effects* - Following the above theoretical discussion, I operationalise partisan effects with two variables: the share of left and of religious parties in parliaments. Most studies (Esping-Andersen, 1990, Huber et al., 1993, Huber and Stephens, 2001) have operationalised political variables by looking at cabinet shares, or the presence of the relevant political forces in government. Here I prefer parliamentary representation for three reasons. First, cabinet shares underestimate the indirect influence that a strong opposition party may have on policy, for example by putting forward popular policy proposal that may force the government to take action in a given policy field. Second especially in countries with majoritarian political institutions, cabinet shares overestimate the extent of variation in the political influence of the relevant actors. In

these countries, for most parties this indicator resembles a dummy variable, taking only 0% and 100% as values. This measure clearly does not reflect the more gradual character of the evolution of political influence. Third, in countries with multiparty systems, a strong opposition may be effectively able to veto policies that are half-heartedly supported by a coalition government. Parliamentary and government composition are obviously strongly related. For left parties between 1980 and 2003  $r = 0.62$ .

*Economic openness* - Economic openness is measured with a simple indicator of exposure to international trade: the sum of imports and exports as a proportion of GDP (trade openness).

*Interaction left power - economic openness*. The hypothesis that the Left will turn to ALMPs when acting in an economic context characterised by strong exposure to international competition, is tested with an interaction term:  $\text{leftpower} * \text{trade openness}$ .

*Crowding out effect* – The crowding-out hypothesis presented above assumes a negative effect of spending on traditional social policies on new ones, such as active labour market policies. Since the effect travels through spending figures, it is possible to observe it by focusing on precisely this aspect. The crowding out hypothesis is tested with the variable “spending on old age as a percent of GDP”, lagged by one year. The more a country is spending on old age, the less it will be able to assign extra resources to ALMPs. While discussing this hypothesis, one should also take into account the fact that, for a variety of reasons, different countries probably consider different levels of social expenditure as the highest acceptable level. Put it another way, one can expect the crowding out effect to kick in at a different level in different countries. For this reason one needs to control for overall social expenditure. The inclusion of the variable “social expenditure as a percent of GDP” allows us to control for this and to make the putative crowding out effect visible. The two variables (spending on old age and total social expenditure) are correlated ( $r = 0.71$ ) but according to the usual tests not strongly enough to create a multicollinearity problem.

*Per capita GDP* - Finally, one can assume a relationship between the overall wealth of a country and its ability to develop active labour market policies. For this reason, per capita GDP in purchasing power parities is included in all models.

Table 2: Variable description

To be included.

### ***Pooled time series***

The statistical technique used in this study is pooled time series, also known as times series cross sectional (TSCS) analysis. Variables are measured at different points in time in a sample of countries. This procedure has a number of advantages. First, it allows researchers to simultaneously exploit variation across space and time to test their hypothesis. Second, it increases dramatically the number of observation (N), allowing researchers to build complex multivariate models (in this case 21 countries X 23 years = 483 potential observations). Of course the use of pooled time series makes sense only if the effects that are being tested can be expected to exist both across space and across time. This is the case only with variables that do change across time. Institutional variables that tend not to move (or never change) are not suitable for this kind of analysis. The variables selected for this study all display a reasonable degree of variation, both across space and time.

Together with these advantages, pooling time series across countries creates other problems. Generally, a pooled time series dataset does fulfil the assumptions that are required for OLS regression analysis to be applicable, such as the absence of correlation among residuals (autocorrelation). Over the years, a number of methods have been put forward as to how to address this issue. The current standard approach in this respect is the one presented by Thomas Plümer and his colleagues (Plümer et al., 2005) who recommend the use of a Prais-Winsten transformation for dealing with the autocorrelation problem. The alternative strategy, including the lagged dependent variable on the right-hand side of the equation, as well as country and time dummy variables, has been criticised because these “technical” corrections explain almost 100% of the variance in most models, leaving very little to be accounted for by the variables which are of theoretical interest.

## **Results**

Many of the independent variables studied in this paper are obviously associated. Even though this does not create a multicollinearity problem, association among IVs affects the individual coefficients in models that combine several variables. For this reason, different models displaying different combinations of IVs are displayed. This allows us to identify some effects independently of the “disturbance” introduced by other variables. It also makes it possible to assess the stability and robustness of the findings.

Table 3: Prais-Winsten Regression of spending on ALMPs, 1981-2003. (z-values in parenthesis)

	Model 1	Model 2	Model 3
Left parties in parliament	0.0008 (0.85)	-0.0050** (-2.60)	-0.0021 (-1.09)
Religious parties in parliament	0.0066 *** (4.31)	0.0039** (2.76)	0.0016 (1.12)
Trade opennes		0.0018 (1.51)	0.0023* (2.15)
Left parties * trade opennes		0.00011** (2.88)	0.0000 (0.87)
Public social expenditures			0.0727*** (9.81)
Spending on old age			-0.0564*** (-5.05)
Unemployment rate	0.0171** (3.06)	0.0187** (3.37)	-0.0013 (-0.21)
p.c. GDP in PPP (1000)	0.0005 (1.28)	0.0002 (0.44)	-0.0001 (-0.30)
Constant	0.424*** (3.55)	0.343** (2.62)	-0.467** (-3.32)
Common Rho	0.83	0.84	0.76
R-square	0.04	0.09	0.33
N	404	404	380

## Discussion

In model 1, only political variables are entered (and the controls). The result support Rueda's claim that Social democracy is unrelated to spending on ALMPs, and contradict Huo's et al findings<sup>4</sup>. This is largely due to the different methods used to control for unemployment. As mentioned above the method adopted here is the one followed by Rueda. If the dependent variable is transformed into spending per percentage point of unemployment and the unemployment rate removed from the controls, than left power has a positive effect on ALMPs spending.

<sup>4</sup> The same result is obtained if the traditional measure of left power is used : cabinet shares instead of parliamentary representation.



Model 1 sheds light also on the role of Christian democrats. Controlling for unemployment and national wealth, Christian democrats are associated with higher spending on ALMPs. The effect is fairly stable, since we find it also in model 2. Cross-sectional analysis of the bivariate relationship between Christian democracy and spending on ALMPs, confirms that this is weakly positive in each year between 1981 and 2003. However, graphic inspection of the data reveals that low average spending levels in countries with weak/inexistent Christian democratic parties are the result of a clear dichotomy between four high spending countries (Nordic) and seven low spending countries, (five English-speaking countries, Greece and Spain). On average, these countries spend less than those with a strong Christian democracy (Germany, Netherlands, Austria, Switzerland), but this is hardly proof of an effect. One should not make too much of this positive coefficient. The only conclusion one can reach is that direct effects of partisanship on spending on ALMPs are either extremely weak or inexistent.

In the theoretical section it has been hypothesised that left power may after all be related to higher spending on ALMPs, but only in the context of an open economy. When in power in a country that is strongly exposed to international competitiveness, a Social democratic party will be strongly under pressure from two sides: its supporters will want policies that are in the interest of workers. Traditional pro-worker policies (such as EPL and early retirement), however, will not be an option, because of their detrimental impact on the country's economic competitiveness. The easiest way out of these contrasting pressures for Social democrats is ALMPs. This hypothesis is tested with an interaction term of left power and trade openness, which, as expected, is positively related to spending on ALMPs (model 2). Countries that are at the same time left-leaning and economically open spend more on ALMPs than countries displaying a different configuration of these two variables. Note that economic openness per se does not have an impact on ALMP spending.

Fixed effects models show that the interaction between left power and trade openness impacts ALMP spending both cross-sectionally and across time. With either time or country dummy variables, the coefficient for the interaction term remains positive and significant at the 0.05 level (models not shown).

Model 3 aims at testing the crowding out effect hypothesised above. One can expect countries that have important financial commitments in the field of old age pensions to be less likely to find the necessary "spare cash" to develop comprehensive systems of ALMP. As argued above, in order to test this effect, one needs to control for overall social expenditure. This is why model 3 contains two additional variables: spending on old age and total public social expenditure.

The result is a strong negative effect. Controlling for total public social expenditure, a one percentage point of GDP increase in spending on old age is associated with a reduction in ALMPs spending of 0.06% GDP points. Note that without the additional control “total public social expenditure” spending on old age is strongly positively associated with ALMP spending. This suggests that, as hypothesised, the crowding out effect kicks in at different levels in different countries, and it is only when controlling for this (through the inclusion of the variable “Total social expenditure”) that the effect becomes visible. In model 3 the interaction term Left power \* economic openness loses significance. This is due to the relatively strong correlation between this interaction term and total public social expenditure ( $r = 0.57$ ). This is consistent with previous research having shown that economic openness tends to be associated with higher levels of social spending (Rodrik, 1998).

Fixed effects models show that the crowding out is essentially a cross-sectional effect. In the model with time dummies, the coefficient remains negative and strongly significant. In the model with country dummies, which highlights the effect across time, the coefficient  $e$  remains negative but loses significance (models not shown).

## Conclusion

What are the drivers of ALMPs? This paper has attempted to shed some light on the factors that facilitate the adoption of active labour market policies. Of course, the data available allowed us to tap only into some of the factors that we can theoretically expect to matter here. One should be aware that there are certainly other important factors that contribute to explain cross-national variation in this field of policy. This limitation is reflected in the relatively low R-square coefficients obtained for our models (they are not smaller than those obtained by Huo et al 2008, though).

The hypothesis put forward in the first part of the paper are nonetheless compatible with the results of the statistical analysis. The view that ALMPs are the first policy choice for Social democrats acting in the context of an open economy and of relatively low commitments to old age pensions is thereby reinforced. But this view is attractive also for other reasons. Most notably, it moves beyond a view of partisan effects being constant across countries. Anyone who has studied or followed politics in more than one western European country knows that the policy preferences of parties carrying the same name are not necessarily identical. The divergence between Nordic Social democrats and the Southern and Continental European left is huge in this respect. By focusing on the interaction between partisan politics and economic variables such as trade openness, this paper promotes a more complex (and arguably accurate) understanding of what Social democrats advocate in different contexts.

It also helps to explain why, today, where the desirability of active social policy has become a new consensus, some countries are still struggling to move in this direction. What they lack may not be the political will, but the spare cash.

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