THE RE-POLITICIZATION OF THE WELFARE STATE AFTER THE GLOBAL FINANCIAL CRISIS

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by

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ABSTRACT OF DISSERTATION

Submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy in Political Science in the College of Social Sciences and Humanities of Northeastern University April, 2016
Abstract

In the aftermath of the worst economic crisis since the Great Depression, the challenges facing welfare states today are unprecedented. While government leaders and European Union (EU) officials were in broad agreement that the severity of recession called for decisive actions and strong social policy responses to limit the social costs of the crisis, national responses have differed significantly (OECD, 2010a). In order to understand why states have pursued such varied crisis management responses, it is vital to identify how the political and institutional factors driving social spending have been altered by this event. This dissertation therefore seeks to answer the critical question: How has the global economic crisis changed the politics of social spending across advanced capitalist economies? While recent comparative welfare state literature has begun to provide explanations for the factors which shape domestic social spending, little research has been dedicated to these effects in the post-crisis period. The lack of research focused on this timeframe is highly problematic as I argue that the global economic crisis has had profound cross-national effects which must be understood in order to explain post-crisis welfare reform trajectories and develop effective crisis management policies. This research examines whether the variables that explain social spending pre-crisis continue to do so in the post-crisis period. In doing so, it will provide key knowledge about the ways in which acute financial crises affect the politics of welfare states and address an important gap in the literature on social protection systems.
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Chapter 1: Introduction

In the aftermath of the worst economic crisis since the Great Depression, the challenges facing welfare states today are unprecedented. While government leaders and European Union (EU) officials were in broad agreement that the severity of recession called for decisive actions and strong social policy responses to limit the social costs of the crisis, national responses have differed significantly (OECD, 2010a). In order to understand why states have pursued such varied crisis management responses, it is vital to identify how the political and institutional factors driving social spending have been altered by this event. This dissertation therefore seeks to answer the critical question: How has the global economic crisis changed the politics of social spending across advanced capitalist economies? While recent comparative welfare state literature has begun to provide explanations for the factors which shape domestic social spending, little research has been dedicated to these effects in the post-crisis period. The lack of research focused on this timeframe is highly problematic as I argue that the global economic crisis has had profound cross-national effects which must be understood in order to explain post-crisis welfare reform trajectories and develop effective crisis management policies. This research examines whether the variables that explain social spending pre-crisis continue to do so in the post-crisis period. In doing so, it will provide key knowledge about the ways in which acute financial crises affect the politics of welfare states and address an important gap in the literature on social protection systems.

In many respects, the current global economic crisis represents a considerable challenge for welfare states and threatens the well-being of people across the globe. Whereas historically during times of economic crisis, social spending has served as a buffer between high levels of unemployment and increases in poverty and social inequality, the ability of the welfare state to provide the same levels of protection has eroded over time (Rueda, 2014). National governments,
however, have varied considerably in their responsiveness to the current economic crisis and its redistributive implications. Given the importance of an effective welfare state response, it is vital to identify the political and institutional factors which promote or constrain social spending in response to acute financial shocks. An effective social policy response not only lessens the immediate negative effects of economic decline, but may also lead to more effective crisis preparedness and improved social policy in the future (Islam and Chowdry, 2010; Prasad and Gerecke, 2010).

This research examines several complimentary factors theorized to be influential in shaping social spending outcomes. These factors include EU influence, welfare institutions, electoral systems, and political party control of government. I argue that while these variables may have been important in shaping social spending under normal economic conditions their effects have been significantly altered in the aftermath of the Great Recession, often in surprising ways. Only by understanding the relationship between these political and institutional factors and the social spending responsiveness of states will we be able to assess the full consequences of the global economic crisis as well as anticipate and limit the potential effects of future crises.

My findings indicate that the politics of post-crisis social spending are fundamentally different than those at play during times of relative economic stability. I argue that under these crisis conditions domestic electoral systems and the party composition of governments play a key role in shaping social policy responses; however, these political variables are conditioned in important ways by existing welfare state configurations and EU institutions and policies. Whereas the existing comparative welfare state literature identifies the importance of electoral systems and party politics, my findings indicate that these variables were relatively unimportant in defining social spending in the pre-crisis period, yet became highly significant in the post-crisis setting.
Although social spending in the decades preceding the crisis was largely depoliticized with widespread political consensus over neoliberal policy proscriptions being reached across countries and political parties (Hendrik et al., 2004), in the aftermath of the global economic crisis social spending reductions and neoliberal austerity policies have been subject to far more intense political debates and partisan conflict. This signifies the vital role that political factors have played, since the onset of the crisis, and highlights an important change in the dynamics shaping social spending outcomes. Importantly, these new social spending dynamics have not been fully explored by the existing literature.

Ultimately, I argue that the global economic crisis triggered increased polarization between political parties on the left and right and the politicization of social and economic policymaking. As a result, political variables, including electoral systems and party control of government, gained far greater significance in shaping social policy outcomes both domestically and at the European level. These political conflicts, which arose within states in the aftermath of a crisis, have been mediated in important ways by welfare institutions and political structures, which have either exacerbated or reduced divisions. In other words, domestic political structures, in the form of welfare systems, and EU institutions, have helped shape national political decisions over whether to pursue a strategy of retrenchment or expansion (Starke et al., 2012). This research, therefore, provides important insights into when and under what conditions political and institutional variables shape government social spending levels.

**Dimensions of Social Policy Spending**

This research examine several dimensions of public social spending, a category covering a wide range of government provisions to ensure the welfare of citizens and measures to protect against the effects of economic downturn. To begin, I analyze overall levels of social spending.
Social spending as a percentage of GDP offers a useful measure of the broad level of support that different states provide to their citizens in response to the crisis. In addition, I explore expenditures for five social policy areas central to advanced welfare states. Each variable serves as an important indicator of social spending generosity.

Levels of unemployment spending, which include provisions such as direct compensation, severance pay, and early retirement, offer a means to measure the responsiveness of states to rising unemployment in the post-crisis period. Second, old age social spending, including pensions, early retirement funds, residential care, and other in-cash or in-kind benefits, serves as an indicator of the degree of social protection for retired individuals outside of the labor market. Third, public health expenditures on in- and out-patient care, medical goods, and prevention are included as another measure of social support. Fourth, public spending on family policies, including child allowances and credits, childcare support, income support during leave, and sole parent payment, provide another important measure of social protection. A high degree of spending on family support policies, for example, may facilitate greater female workforce participation. Finally, I examine government spending on active labor market policies (ALMPs). ALMPs are of particular importance in the post-crisis period as states seek to address the needs of labor market outsiders, including youth, women, and part-time workers, disproportionately affected by high unemployment. Youth unemployment rates throughout the OECD, for example, have remained twice as high as the average unemployment rates for the adult working population (see Table 1). In some cases, youth unemployment is staggeringly high and has become a severe problem in some countries, such as in Spain and Greece where the youth unemployment rate exceeded 50% in 2012.

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1 Unemployment policies include a number of different provisions such as direct compensation, severance pay, and early retirement (OECD 2014).
2 ALMPs include spending on public employment services, labor market training, school-to-work youth programs and employment programs for the disabled (OECD 2014).
The objective of ALMPs is to benefit such outsider groups by facilitating skill development and entry into the workforce. The goal in other words is to try and generate new employment opportunities and provide stable employment for outsider groups who have limited labor market mobility (Rueda, 2014, 388). In addition to addressing some of the social concerns of those groups most affected by the crisis, ALMPs offer a way for states to offset rising welfare costs. Many states have begun to adopt ALMPs as a strategy to address long-term unemployment thereby limiting the rising costs of passive social assistance and unemployment insurance benefits (Martin and Thelen, 2008, 16; Townsend, 2009). In other words, ALMPs may represent a more effective and cost efficient social policy response in the post-crisis period.

Table 1. OECD Unemployment Rates by Age (2005-2012)

Source: OECD LFS by Sex and Age Indicators
Methodology

This research incorporates a mixed-methods approach to identify the significance of political and institutional variables on the social policy crisis management responses of advanced welfare states. Statistical models, utilizing panel data, have been run for several different dimensions of social spending accounting for the pre-crisis (1990-2007) and post-crisis (2008-2013) periods. This quantitative model allows me to test whether the same explanatory variables remain statistically significant and what effects they have in both periods. For those variables which are statistically significant, an examination of pre- and post-crisis data will reveal what direction these variables have on state social spending. Measures have also been included to determine the magnitude of these effects in both periods. This is important as it allows me to differentiate between variables which remain significant in both periods to determine whether they are having a stronger or weaker effect on the dependent variable in each timeframe. The model includes data for 28 OECD countries over a period of 24 years, which allows for greater explanatory power of social spending patterns across a number of states and highlights the substantial and varied impact that the crisis has had across countries.

Several different public social spending measures have been included in this research as dependent variables. First, I examine overall levels of social spending. Public social spending as a percentage of GDP offers a useful measure of the broad level of support that different states have provided to their citizens in response to the crisis. In addition, I investigate expenditures for five social policy areas central to advanced welfare states: unemployment policies, old age benefits, 

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3 The post-crisis period refers to the timeframe after the advent of the global financial crisis beginning in September 2008. It is important to acknowledge that the crisis has been evolving and ongoing. Post-crisis therefore does not indicate a cessation of the crisis, but rather indicates the period of time that has elapsed since its inception.

4 The Organization for Economic Co-operation and Development (OECD) is an international economic organization comprised of 34 member states representing many of the world’s advanced as well as emerging countries.
health provisions, family services, and active labor market policies. Each variable serves as an important indicator of social spending generosity. By exploring the different aspects of social spending outcomes, this research will provide a more nuanced understanding of how different states responded to the crisis.

This quantitative research has been coupled with case study analysis of Germany, the United Kingdom (UK), Sweden, Spain, and the Czech Republic. Each case is representative of a different welfare system and provides useful insights for a wider array of countries. Observing domestic political debates over social policy during the crisis for each case has allowed me to provide detailed explanations of the political factors driving social spending in each country. Qualitative analysis has allowed me to examine whether welfare structures, electoral institutions, and political parties have been important in defining political dividing lines within states and whether they have facilitated or hindered social spending post-crisis. I also examine whether EU attempts to promote social spending have influenced domestic policies. Ultimately, by exploring the causal mechanisms shaping post-crisis national social policy responses this research answers important questions about the varied effects of the global economic crisis on the well-being of people across countries. By identifying the factors which lead to more effective social protection responses, this research seeks to inform policymaking in order to develop more effective crisis management responses and improved social policy in the future.

**Evolution of the Global Economic Crisis**

This dissertation examines cross-national changes in social spending in response to the global economic crisis. Before delving into the specific history of the most recent economic crisis, two important points about the term *crisis* must be addressed. The first point has to do with the
particular definition and meaning of crisis, which must be differentiated from how it has been commonly described in the traditional welfare state literature. The second point has to do with identifying the timeframe of the crisis so that clear parameters are set to understand what is meant by the pre-crisis and post-crisis periods. To begin with, it is important to clarify that the term crisis in the context of this dissertation has a very precise meaning. Within the welfare state literature, there has been longstanding reference to the crises faced by welfare states, referring to shifting social, economic, and demographic challenges that social protection systems are confronted with and the lack of funding for welfare state expansion that has persisted since the 1970s. Crisis for the purposes of this research, however, refers specifically to the severe social and economic challenges that advanced welfare states have been confronted with as a result of the severe and rapid global economic downturn.

The collapse of the global financial market triggered the worst economic crisis in nearly a century, resulting in the loss of trillions of dollars in GDP and millions of jobs worldwide (Atkinson et al., 2013; Wall Street Journal, 2012a; World Bank, 2014). The severity of this crisis cannot, therefore, be understated and its effect on the politics of social and economic policymaking is unprecedented in the modern age. While Europe had seen steady growth in the decade preceding the global economic crisis, beginning around 2008 GDP plummeted sharply across EU member states (see Table 2). At the same time, the unemployment rate rose significantly throughout the region as firms and other private sector actors began to reduce large portions of their labor force (see Table 3). The crisis, therefore, represented a serious threat to economic, political, and social stability across countries. In response to growing unemployment and other social concerns, real social spending increased markedly starting in 2008. At the same time real GDP on average shrank throughout Europe, resulting in a growing debt and deficit problem for governments who were
increasing public expenditures to try and offset the negative social effects of the crisis and stimulate economic growth. Across the OECD, the social spending-to-GDP ratios grew markedly during the economic crisis (see Table 4). The long-term social and economic policy responses which national governments pursued, therefore, have taken place within a broader context of austerity and limited budgetary capacity as the crisis wore on.

**Table 2. Annual Growth Rates of Real GDP, Change Over Previous Year (2000-2013)**

![Graph showing annual growth rates of real GDP](image)

Source: OECD Quarterly National Accounts

**Table 3. Harmonized Unemployment Rate (2000-2013)**

![Graph showing harmonized unemployment rates](image)

Source: OECD Key Short-Term Economic Indicators
Table 4. Real social spending, real GDP, and social spending as a % of GDP (2007-2012)

Source: OECD 2012

Second, for the purposes of analysis, this research dates the start of the global economic crisis as beginning in 2008 and continuing to the present. This timeframe marks a departure from earlier social spending patterns, as national governments began to implement crisis management responses to limit the effects of this event on domestic markets and on the public. While 2007 saw global economic slowdown, it was not until September 2008, following the bankruptcy of Lehman Brothers, that we see the beginning of a truly worldwide economic crisis. As this section will explore, what started as a global financial market crisis in 2008 rapidly became a far-reaching economic crisis characterized by high levels of unemployment and low levels of domestic growth across countries. By 2010, it had become a sovereign debt crisis and a larger social crisis. Each phase of the global economic crisis was followed by highly divergent national responses that have had profound effects throughout the region. This section provides an overview of the distinct phases of the global economic crisis within Europe beginning in 2008 and continuing to the present day. Understanding these broad shifts will be important to understanding the reasons why states
responded to the crisis in such different ways and highlight the varied social, political, and economic outcomes this event has had across countries.

While it is clear that the social policy responses of governments in the initial aftermath of the crisis played a critical role in limiting the impact of this event, differences in cross-national stimulus responses, and later austerity measures, have led to significant divergence between EU member state outcomes. Domestic crisis management policies have also had important effects within some countries resulting in growing labor market inequalities and lower levels of social solidarity. This divergence between states and within countries has had profound implications for establishing effective European strategies for economic recovery and social protection.

The First Wave of the Global Economic Crisis (2008-2010)

The collapse of international financial markets in 2008 led to rapid stimulus responses by national governments across advanced states seeking to counter the negative effects of the crisis. Within Europe, EU member states pursued relatively coordinated counter-cyclical Keynesian stimulus responses in accordance with the European Economic Recovery Plan guidelines put forth in 2008 by the European Commission (Leschke and Jepsen, 2012). The goals of the Commission’s recovery plan were to restore consumer and business confidence, bail out struggling banks, stimulate investment in European economies, support hard hit industries, including construction and manufacturing, protect vulnerable groups, create jobs, and lower unemployment rates (European Commission, 2008). While some experts categorized the overall stimulus measures adopted by national governments as extremely modest, given the scale of the crisis, by supporting collapsing financial markets and bolstering economic demand these measures have largely been
credited as preventing a much more serious and lasting global depression (IMF, 2009; Leschke and Jepsen, 2012).

During the period from 2008 to 2010, EU fiscal stimulus measures infused around 1% of GDP on average per year back into the European economy (European Commission, 2009a). However, while there were fairly coordinated stimulus response measures across states, the size and content of bailout packages varied considerably, reflecting differences in the extent of automatic stabilizers and institutional setups within welfare states, the severity of the crisis on domestic economies, and increased political contestation over discretionary spending in certain states. Whereas some member states were able to weather the crisis fairly well, increasing debt and deficit levels limited the ability of other states to provide the level of support needed to stem the crisis (Watt, 2009). For example, whereas Austria, Germany, Sweden, and Finland were able to adopt stimulus measures equivalent to over 3-4% of domestic GDP, other states, like Hungary, who were economically harder hit, were unable to increase public spending at all (European Commission, 2009a; Leschke and Jepsen, 2012). This indicates that even at the early stages of the crisis there was considerable variation in domestic crisis responses.

Differences in domestic stimulus responses led to significant disparities in social and economic outcomes across states. While some wealthy countries responded to this event with effective stimulus measures many economically weakened states implemented limited response measures or were forced to cut back on social spending leading to continued economic downturn and worsening social conditions within these states. Whereas, during the first two years of the crisis unemployment increased on average by 2% throughout the EU and GDP fell by around 5% there was significant variation across member states (Leschke and Jepsen, 2012). For example, while the German economy shrunk by 6% of GDP, the unemployment rate was lower than it had
been pre-crisis, in large part this was due to the comprehensive and well-funded stimulus measures designed to protect jobs (Leschke and Jepsen, 2012). By contrast, the Spanish economy contracted by only 4% of GDP, but experienced an unemployment rate increase of 7.5% (Leschke and Jepsen, 2012). The downturn was far worse in Eastern Europe where Baltic states between 2008 and 2009 faced an average increase in unemployment of over 10% and a reduction in GDP of up to 20% (Leschke and Jepsen, 2012). This variation indicates that not only did the crisis impact states in different ways, but the capacity of national governments to address this economic downturn differed considerably.

**The Second Wave of the Global Economic Crisis (2010-Present)**

By 2010, it was clear that the global economic crisis was having a serious destabilizing effect on government finances throughout Europe with public debt and deficits rising to unsustainable levels (Theodoropoulou and Watt, 2011). The stimulus measures, while helping to stem the initial effects of the economic crisis, left state coffers drained at the same time that growth and revenue streams were declining in states, such as Spain, Ireland, Greece and Portugal (Leschke and Jepsen, 2012). These problems came to a head in the spring of 2010 as a significant loss of confidence began to grow over the Greek economy and the government’s ability to pay its debts. This loss of confidence in Greece marked the beginning of a larger sovereign debt crisis throughout Europe and a turning point in national crisis management responses. This second phase of the crisis coincided with the implementation of austerity measures across states in an attempt to reduce spending and increase revenues. Such efforts were a significant reversal of policies to address the crisis. Whereas in 2008 and 2009 measures were implemented to stimulate domestic markets and expand social protection benefits by 2010 countries began to cut budgets and make structural
reforms with the hope of encouraging growth without increasing public expenditures (Leschke and Jepsen, 2012).

In many states, social protection measures became the target of drastic spending cuts as welfare state institutions came under severe financial strain. However, while all member states began to reduce social spending after 2010, as was the case with the stimulus packages, the degree of austerity implemented varied widely across states. In other words, there has been significant divergence in the ability of national governments to balance the need for reduced public expenditures while maintaining adequate social welfare provisions. Cuts in social spending as a percentage of GDP have been the greatest in Eastern and Southern European states, which were already underperforming in terms of economic growth, unemployment rates, and social protection indicators. By contrast, social spending reductions have been considerably lower in wealthier states in Central and Northern Europe. According to the European Commission’s 2011 Stability and Growth Programmes, public expenditures between 2010 and 2014 will be cut by 15-20% across most Eastern European states, while similar cuts are expected to be less than 10% of GDP in Central and Northern European countries, such as Belgium, Denmark, Finland, Germany and Sweden (Leschke and Jepsen, 2012; Theodoropoulou and Watt, 2012). In some of the states most hard hit by the crisis, cuts in total public expenditures and social spending is expected to be significantly higher. For example, the planned spending cuts in Ireland between 2010 and 2014 amount to 40.1% of GDP (Leschke and Jepsen, 2012). In fact, the pressure to reduce social benefits has been particularly strong in countries that have needed bailout funds from the EU and IMF. These states include Greece, Hungary, Ireland, Latvia, Portugal, and Romania (Leschke and Jepsen, 2012).
In sum, the austerity measures adopted by most EU member states in response to increasing public debt and deficits have been uneven with some states making much more drastic cuts to social expenditures than others. In fact, those states that have been most hard hit by the crisis have typically been the least able to respond effectively with counter-cyclical measures and have instead implemented deep spending cuts. This is problematic as these cuts have prolonged the effects of the crisis within these countries and have had a destabilizing effect on European markets and politics more broadly. These conditions in turn generated increased political conflict and polarization which has further shaped domestic social spending outcomes. Ultimately, there has been a significant divergence in the crisis management response of governments and a widening the gap between states in terms of economic performance and social protection.

Divergence Between States and Within Countries

The global economic crisis has had a clear and pronounced effect across welfare states. In addition to altering overall social spending patterns, the crisis management responses of different governments are widening divisions between states and within countries (Leschke and Jepsen, 2012). During the first phase of the crisis, social spending increased on average throughout the EU, however, there was significant regional variation, with well-funded welfare states in Central and Northern Europe providing the highest levels of countercyclical spending. Wealthy states, including Austria, Finland, Germany, Sweden and the UK, for example, each spent at least 2% of their GDP on ALMPs and household support policies (European Commission, 2009a). By contrast, Eastern European states including Bulgaria, Cyprus, Hungary, Lithuania, and Romania each spent less than 0.1% of their GDP on these same policy areas (European Commission, 2009a). Given the importance that countercyclical social spending has played in minimizing the negative
consequences of the economic crisis, stark differences in government responses has contributed to an uneven recovery and worsening conditions across the EU.

In addition to significant cross-national variation in the willingness and capacity of states to effectively respond to the economic crisis, in some cases stimulus measures have increased inequality and lowered social solidarity within countries as certain groups have benefitted more than others. For instance, social spending increases in Continental, Southern, and Eastern Europe have often targeted full-time employees with standard contracts leaving part-time workers and other labor market outsiders more exposed in the aftermath of the crisis (Leschke and Jepsen, 2012). In fact, outsider groups that were disproportionally affected at the start of the crisis, such as younger workers, have seen their situation worsen as unemployment for this group has risen considerably (see Table 1). Austerity measures which are largely seen as regressive are expected to further intensify these inequalities within countries (Leschke and Jepsen, 2012). Such widening inequality is likely to be far more pronounced in countries already struggling the most in the aftermath of the crisis as they are under increased pressure to cut social expenditures at the same time that they are faced with high levels of unemployment and poverty, a dynamic that is highly problematic as planned social spending cuts are positively correlated with the risk of poverty and social exclusion (see Table 5).
Table 5. Risk of poverty or social exclusion (2009) and planned changes in social spending, 2010–14 (percentages)

![Graph showing the relationship between risk of poverty or social exclusion and planned changes in social spending.](image)

Source: Leschke and Jepsen, 2012

**Conclusion and Significance of Findings**

The crisis clearly highlights the importance of political and institutional variables not only in affecting the kinds of challenges that different states faced, but in shaping the types of social policy responses that national governments pursued. How each country dealt with the crisis has depended largely on domestic political contestation and institutional setups. In this research, I argue that the post-crisis divergence across states and within countries has been driven by the reemergence of welfare state politics after the global financial crisis. Political contestation between parties on the left and right became heightened during the economic crisis as old cleavages resurfaced. While existing literature points to the importance of political parties and electoral systems in shaping
social sending outcomes, my research indicates that these factors had surprisingly little effect pre-crisis, yet took on markedly increased significance during it. Whereas parties on the left largely embraced neoliberal social and economic policies before the crisis, since the crisis began they have turned to toward more traditional policy stances. This left-ward shift by center-left parties has led to greater contestation with conservative parties who have largely continued to support neoliberal strategies of austerity and fiscal discipline. In addition to the greater cleavage that has grown between traditional center-right and center-left parties, the post-crisis political environment has seen a dramatic rise in far-left and far-right parties indicating a growing polarization among the electorate in some countries. This highly politicized post-crisis policymaking environment is in stark contrast to the depoliticized nature of pre-crisis social and economic decision-making.

Political contestation, however, has been mediated in important ways by existing social protection systems and EU influences. In wealthier welfare states, automatic stabilizers allowed for uncontested increases in social expenditures and provided protection to citizens. By contrast, states with less generous social protection systems have had much weaker automatic stabilizer responses and, therefore, decisions on whether to increase social spending have been subject to partisan political debate. The result has been a much weaker social response on behalf of these states, leading to notably worse social and economic conditions. In addition, EU policies have helped to shape national responses at each phase of the crisis, from the early introduction of stimulus packages to a focus on fiscal discipline and austerity measures as the crisis continued.

By focusing on the political dimensions of social welfare crisis management, this research seeks to make a significant scholarly contribution and provide key insights for policymakers. My findings indicate that political factors, including electoral systems and political party control of government, while insignificant in the period prior to the crisis, became highly influential in
shaping social spending outcomes once crisis ensued. In fact, the post-crisis period is one defined by highly contentious political divisions. This is an important finding not accounted for in the existing literature, which assumes that these variables have a constant effect over time. My research also identifies the important mediating effects that welfare structures and EU institutions and policies have on these political dynamics. Whereas domestic institutional arrangements feature prominently in much of the welfare state literature, little consideration is given to how their effects differ during times of severe economic downturn. EU institutional effects on national social spending are also underexplored in welfare state research and require further examination. By addressing important gaps in the welfare state literature, my dissertation adds to our understanding of the important ways in which social spending is effected during times of severe economic crisis. In particular, this research will help shed light on when and under what conditions political and institutional variables influence social spending outcomes. In doing so, it will allow us to differentiate post-crisis spending patterns from those that occur during times of relative economic and social stability.

My findings also have serious implications for recovery efforts, including how to develop effective short-term social policies and establish better long-term crisis response measures. The global economic crisis has impacted the lives of millions of people throughout the globe. An effective welfare response is the primary source of protection for citizens during times of crisis. However, national responses to the crisis have varied considerably. This is problematic as some state responses have been insufficient to address the needs of their citizens. Ineffective social policies can result in continued economic stagnation and worsening conditions for vulnerable populations. Due to the uneven effects of the crisis across states, developing a comprehensive response has been a vital issue. This has been particularly true for the EU, as policies of fiscal
austerity have further worsened the crisis in some states, most notably in Southern and Eastern Europe. My research will provide important information about the challenges that different states face and the varied ways in which governments have responded to the crisis. This assessment of cross-national social policy responses will provide valuable insights for policymakers about what is driving divergence across states and within countries, thereby, allowing them to craft better and more nuanced social policy responses.

**Chapter 2**

Chapter 2 examines important political and institutional theoretical explanations for variations in national social spending outcomes within the welfare state literature. The chapter will begin by exploring the anticipated effects that acute financial crisis events are theorized to have on social welfare systems. This will provide an important account for how these disruptive phenomena alter domestic social spending patterns. I will then explore the rich literature on the significance of welfare systems in shaping domestic social spending outcomes. According to this perspective, the distinctive historical and institutional characteristics of welfare states influence domestic social spending patterns and play an important role in structuring the political debates within states regarding social policy outcomes. Next, I examine the literature on the importance of electoral systems and the political composition of national governments in shaping levels of social spending. According to this perspective, differences in political institutions and party composition generate different coalitions across states, which in turn produce systematically different policy responses to social and economic challenges. Finally, I examine the important, but underexplored effect that EU institutions and policies are hypothesized to have on welfare state spending across members states.
Chapter 3

Chapter 3 will provide a quantitative examination of the politics of social spending in the pre- and post-crisis periods utilizing OECD data for 28 advanced industrialized countries. Using a random effects model, this chapter will explore the ways in which the crisis has reshaped the global social and economic environment and the effects this has had on the politics of social spending across countries. Econometric analysis of panel data will provide a test of several independent variables identified in the comparative welfare state literature to determine whether these variables remain significant in the post-crisis period. This chapter will explore the domestic level effects of welfare regime type, electoral system, and political parties on the social spending responsiveness of states to the crisis. It will also examine the influence of EU institutions and policies on the levels of social spending post-crisis. The results of this quantitative analysis will provide a contemporaneous overview of how social policies have been affected by the crisis and will identify the underlying political and institutional variables which influence social spending responses across advanced industrialized states.

Chapter 4

Chapter 4 provides an in-depth analysis of the effects that EU institutions and policies have had on the social spending patterns of member states in the pre- and post-crisis periods. It explores general trends in social spending across EU and Eurozone members in the pre-crisis period and identifies how these patterns have changed in the aftermath of the crisis. The chapter will examine the effects of European economic integration on state social spending. This includes the effects that the 2012 European Fiscal Compact has had on member state social spending. The chapter will also explore whether the increased emphasis at the EU level to promote “Social Europe” has
been effective in shaping social spending outcomes in member states. Analysis of policies that seek to promote a European Social Model, such as Europe 2020, will help to identify whether the EU has been able to bridge the vast institutional divide between the social policy arrangements of member states to identify best practices and foster mutual learning. This chapter will also provide an in-depth exploration of the increased political divisions that have taken place at the European level in the wake of the economic crisis, both in the form of interstate conflict between member states and between EU institutions and countries. As this chapter will detail, growing political conflicts between advocates of strict austerity measures and proponents of a pro-growth agenda have been critical in shaping the long-term European recovery efforts and social spending outcomes.

**Chapters 5-9**

Chapters 5 through 9 provide qualitative case study analysis of five European countries, Germany, the UK, Sweden, Spain, and the Czech Republic to gain a better understanding of the causal mechanisms that result in different levels of social policy responsiveness to the global economic crisis. All five states display important variation in the independent variables identified earlier. The UK is representative of a liberal welfare regime with a majoritarian electoral system. Sweden by contrast is characteristic of a Nordic welfare regime with PR electoral system that lacks strong CD party representation. Germany is representative of a Continental welfare regime, with a PR electoral system and a strong CD party presence. Spain is representative of a Southern European welfare regime, with a PR electoral system. The Czech Republic is representative of an Eastern European welfare regime with a PR electoral system. Additionally, although all five countries are EU member states, only Germany and Spain are Eurozone members. As EU
members, Europe 2020 applies to all five states. However, whereas Germany, Sweden, Spain, and the Czech Republic are all signatories of the 2012 European Fiscal Compact, the UK has opted out of signing the treaty.

Observing domestic political debates over social policy in the post-crisis period for each case will allow me to provide detailed explanations of the political factors which drive social spending within each country. Qualitative analysis will allow me to examine the ways in which different welfare structures, electoral institutions, and political parties have been important in defining political dividing lines within states and whether they have facilitated or hindered social spending in the aftermath of the crisis. I will also examine whether EU attempts to promote social investment strategies to reduce inequality and improve social solidarity, articulated in Europe 2020, have been incorporated into domestic policies. By examining the politics of social spending in the pre- and post-crisis periods, I will be able to examine whether the patterns of pre-crisis welfare state spending have continued into the contemporary period or whether there has been a notable difference in the types of responses governments have adopted post-crisis.

Chapter 10: Conclusion

The conditions of fiscal austerity, increased unemployment, and low levels of economic growth which have arisen from the global economic crisis place a significant strain on advanced welfare states prompting serious changes in social spending. These changes do not simply entail the need for readjustment in spending allocation, but the adoption of novel policy mixes and approaches to address new pressing social and economic problems. Chapter 10 provides a final analysis of the politics of social spending in the post-crisis period reviewing broad trends in the quantitative data and case specific findings to provide a comprehensive overview of effects of the
crisis. Although all states have been negatively affected by the economic crisis, there has been significant variation in government social spending responsiveness to this event, resulting in different levels of inequality and solidarity across countries. This indicates that while the pressures that each welfare state faces are similar the political and institutional factors driving social policy responses differ significantly. Examining the effects of the crisis will be critical to understanding the ways in which previous patterns of social spending have been disrupted by the global economic crisis. By exploring the causal mechanisms which shape social policy responses in advanced capitalist countries, my research will answer important questions about the influence of the global economic crisis on different welfare states and how this affects the social and economic well-being of people across countries.

My research finds that politics have become increasingly important in the post-crisis period in defining European economic recovery strategies and social policy spending. Whereas the pre-crisis period was defined by greater political consensus over neoliberal policy tools, with liberal welfare strategies adopted across a range of different states, these policies and their ideological underpinnings have been subject to far more scrutiny and debate post-crisis. This signifies an important change in the political dynamics shaping social and economic policies since the onset of the crisis. The result has been a significant divergence between states in terms of the policies they pursue and the social and economic outcomes that they have achieved. This variation makes the adoption of uniform policies for all member states difficult and may require measures that are tailored to the specific economic and social conditions within countries. To achieve this end, a careful balance of economic stimulus to promote growth coupled with longer-term public debt and deficit reductions may be necessary. However, the politicization of post-crisis social and economic policy decisions may make this consensus more difficult to achieve thereby prolonging economic
recovery as ideological standoffs between advocates of austerity and those in favor of stimulus continue. If this is the case, lack of economic growth and worsening social conditions, particularly within Europe’s peripheral countries, may generate increasingly radical political positions, which will make compromise even harder to achieve. Understanding the politics of social spending in the post-crisis period is therefore critical to identifying the challenges and opportunities that advanced welfare states face. These political variables will not only shape the social spending of states in the short-term, but will define the long-term economic recovery efforts and social conditions across countries.
Chapter 2: Crisis and the Politics of Social Spending

This chapter will begin by examining the significance of the 2008 global economic crisis in reshaping the social and economic context in which national governments operate. I will then discuss the significance of this event for the politics of social spending across advanced welfare states. After establishing the importance of crisis events in altering the political dynamics of social spending, I will proceed by reviewing complimentary explanations of social spending variation from the comparative welfare state literature. These explanations will offer important insights into what political and institutional factors are theorized to influence the social spending responsiveness of national governments. My research will examine the strength of each of these independent variables in explaining social policy outcomes and test whether these variables are significant in the pre- and post-crisis periods.

Crisis as a Catalyst for Change

While the comparative welfare state literature has begun to provide explanations for the different factors which shape domestic social spending, little research has been dedicated to these effects in the post-crisis period. The 2008 global financial crisis was a powerful focusing event which propelled social and economic concerns to the forefront of the policymaking agenda and acted as a catalyst for welfare state action. This event has generated new political conflicts concerning economic regulations, social redistribution, and the role of the state in providing effective policy responses to crisis (Starke et al., 2012, 2). An examination of this timeframe is, therefore, critical to understanding contemporary social spending patterns in advanced capitalist

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5 According to Thomas Birkland, a leading public policy scholar, a focusing event can be understood as, “an event that is sudden; relatively uncommon; can be reasonably defined as harmful or revealing the possibility of potentially greater future harms; has harms that are concentrated in a particular geographical area or community of interest; and that is known to policy makers and the public simultaneously” (Birkland 1998, 54).
states, as there is a strong expectation that the global economic crisis has significant altered the politics of social spending across countries.

There are several theoretical reasons for why the crisis would generate a dramatic change in the dynamics of cross-national social spending. To start with, the crisis acted as a powerful shock to the global economy resulting in financial market collapse, economic recession, increased unemployment, and growing social inequality. Several scholars suggest that severe financial crises place pressure on governments to make significant changes in social spending (Kuipers, 2006; Vis et al., 2011, 339). Under normal social and economic conditions there is often social policy continuity, with little change in public spending levels (Palier, 2010, 31). Economic crises, however, create critical junctures which can lead to drastic changes in welfare spending and a sharp departure from the type of social policies maintained during times of relative economic stability (Baumgartner and Jones, 1993; Keeler, 1993; Kwon, 2001; Palier, 2010). In times of crisis, difficult economic and political decisions may be more feasible allowing states to achieve major reforms and reallocations of social spending (Amin et al., 2008; Lewis and Pettersson, 2009; Lewis and Verhoeven, 2010, 83; World Bank, 2010). If taken advantage of these events offer opportunities for states to improve social spending outcomes by reducing ineffective policies and introducing more equitable and sustainable approaches which promote long-term growth and higher levels of employment (Prasad and Gerecke, 2010). However, if done poorly ineffective social policy responses can result in continued economic stagnation and worse conditions for vulnerable populations (Brumby and Verhoeven, 2010, 194).

Social spending recalibration depends largely on the political factors which drive policy decisions within states. Economic downturns place demands on domestic political systems to resolve the economic crisis and limit its negative distributional effects on society. However, post-
crisis conditions of austerity and budgetary constraint force political actors to make difficult choices about which groups pay the costs and which groups benefit from social policy changes giving rise to sharp distributional conflicts (Vis et al., 2011, 338). The resulting changes in political dynamics generate crisis policy responses that differ from previous social spending patterns (Kvist, 2013, 104). Crises, therefore, disrupt existing patterns of social spending leading to notable changes in government policies. We should expect, however, to see social spending responsiveness to these events vary based on the different capacity of states to react effectively to the crisis and address rising political conflict generated by distributional demands.

Theoretical arguments within comparative welfare state literature, therefore, suggest that the 2008 global economic crisis should serve as a catalyst for major changes in the politics of social policy spending across advanced industrialized welfare states, for several reasons (Hemerijck et al., 2009; World Bank, 2010). First, the crisis had a direct economic impact on existing social policy arrangements. High levels of unemployment created pressure for national governments to adopt counter-cyclical measures to ensure the protection of citizens from the consequences of economic downturn (see Table 6). Rising unemployment has been particularly problematic for EU member states and Eurozone countries where unemployment has remained above the OECD average and has continued to increase in the post-crisis period (see Table 6). This has raised concerns over the capacity of domestic social policies to address these problems and the long-term financial sustainability of these programs. As a result, many long-standing problems may be exacerbated further by the crisis. For example, in Continental welfare regimes, increased economic and social pressure is likely to intensify debates and political contestation between insider and outsider groups over who has access to welfare benefits (Häusermann and Palier, 2008; Rueda, 2007, 2014).
Second, at the same time demand for social welfare has increased government spending has been constrained by low growth and fiscal policy reforms. Newly adopted EU economic policies, such as the 2012 Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (hitherto referred to as the European Fiscal Compact), place significant limits on the amount of domestic spending a state can undertake. The objective of these agreements is to strengthen and coordinate fiscal policies across members of the Eurozone and limit government deficits in order to ensure financial stability (European Council, 2012). Given these economic conditions, domestic policymakers are faced with the dilemma of trying to contain deficits and ensure fiscal discipline while at the same time attempting to protect citizens from the negative effects of the crisis (Lewis and Verhoeven, 2010, 80). On average, social spending constitutes nearly half of all public expenditures in OECD countries representing a large burden on public budgets (Starke et al., 2012, 2). However, despite the large public cost, social spending also serves as an important protection for vulnerable populations during times of economic downturn and functions as an important counter-cyclical macroeconomic stabilizer.

Third, the distributional effects of the crisis have led to increased politicization and public debate over social policy. Existing research indicates that the prominence of social and economic issues is heightened after a crisis thereby placing some of the most divisive political issues on the agenda (Singer, 2011). More recent research indicates that political polarization is likely to become far more pronounced after severe financial shocks (Funke et al., 2015; Stanig, 2013). In some cases, such politicization may reinforce existing political divisions thereby limiting social policy responsiveness. In other cases, by increasing the importance of social issues the crisis may allow policymakers to overcome obstacles and increase spending to counteract the negative effects of economic downturn (Baumgartner and Jones, 1993; Cobb and Elder, 1983; Kingdon, 1995; Light,
1982; Walker, 1977). The political conflicts that arise within states are mediated in important ways by welfare institutions which can exacerbate or reduce divisions. For example, low levels of social spending support are strongly associated with increased political polarization (Lindqvist and Östling, 2010; Swank and Betz, 2003). Political dynamics and welfare state arrangements are, therefore, theorized to shape whether a national government pursues a strategy of retrenchment or expansion (Starke et al., 2012, 2). In either case, the crisis intensifies political debate over social spending allocations and creates pressure for immediate action by government officials.

Table 6. Harmonized Unemployment Rates (2005-2013)

![Graph showing harmonized unemployment rates (2005-2013)]

Source: OECD Key Short-Term Economic Indicators

Finally, the global financial crisis powerfully challenged neoliberal economic beliefs by exposing the weakness of existing policies and regulations. As a result, the cross party political
consensus that had formed around these policies in the pre-crisis period was disrupted. As a result, the crisis has sharpened ideological divisions between political parties on the left and the right that promote very different strategies for how best to resolve the crisis. Whereas center-right parties largely argued for fiscal discipline and more liberalization, center-left parties have raised concerns that such policies only prolong the crisis and lead to worsening social conditions. The return of Social Democratic and other left-leaning parties to power, for example in France and Sweden, signals a growing anti-austerity sentiment among some European citizens and represents a strengthening of opposition to the austerity policies advocated by states such as Germany and the UK. In countries struggling with long-term economic downturn, such as Greece and Spain, opposition has become even more pronounced with far-left and far-right populist parties gaining support on public anti-austerity sentiments. This growth in political conflict since the start of the crisis reflects deeper ideological divisions as to the legitimacy and effectiveness of austerity policies being pushed by powerful elites. The crisis has, therefore, ushered in a new period of ideological conflict over the role of the welfare state.

Historically acute financial crises have produced similar challenges to prevailing economic beliefs. The Great Depression and the devastation of World War II saw Keynesian economic beliefs gain ground which paved the way for the development of the modern welfare state. The Stagflation Crisis of the 1970s saw a weakening of support for Keynesian policies and a turn toward neoliberal theories. With the end of the Cold War and emergence of China in particular, neoliberalism had become the dominant global economic paradigm. Informed by neoliberal beliefs was significant cross-national welfare liberalization during this time. While the 2008 global economic crisis may not signal an end to the neoliberal paradigm, it has called into question many of its underlying assumptions, resulting in intense political conflict over market regulations and
the role of the welfare state in providing effective policy responses to crisis. In sum, the crisis profoundly altered the political and economic context across countries which is expected to significantly affect social spending patterns and dynamics.

**Domestic Political Factors**

Although many states have faced similar social and economic problems in the post-crisis environment, different political and institutional variables are important in explaining social spending variations across countries. It is important to examine how the relationship between these explanatory variables and welfare state spending outcomes might have changed as a result of the crisis. First, the crisis may have significantly altered the social and political context rendering independent variables, which were statistically significant in shaping social policy spending in the past, irrelevant in the post-crisis timeframe. For instance, while welfare regime type may have been a significant factor in explaining differences in social spending in the pre-crisis period these structures may no longer be important in defining state responsiveness in the contemporary context or vice versa.

Second, even if the crisis has not disrupted the political factors shaping social spending, it may change the magnitude of the effect of different explanatory variables. Electoral systems, for example, may have a more or less pronounced effect in shaping social spending in the post-crisis period. Third, while explanatory variables that were significant in explaining social spending in the past may still be statistically significant the direction of the effect may have changed. For example, while liberal welfare regimes might have been statistically significant in the pre-crisis period in promoting modest positive levels of social spending in the post-crisis period these
regimes may still be significant, but have a negative effect as states pursue social spending cutbacks.

Ultimately, increased social and economic pressures stemming from the crisis have required major policy interventions by national governments. Despite the recognition of the need to provide effective social protection many states have differed significantly in their policy responses. In fact, while it is clear that the global economic crisis has had a significant impact across states, the severity of the crisis on domestic markets is a relatively poor indicator of the direction of social policy response (Armingeon, 2012; Starke et al., 2012, 9-10;). Instead, the post-crisis social spending response of a state, whether towards retrenchment or expansion, is heavily conditioned by political and institutional variables operating within countries and at the international level. Understanding, the nature of the relationship between political explanatory variables on social spending in the pre- and post-crisis periods will be vital to providing greater insight into how various states have been affected by the economic crisis. The next two sections will explore the differential impact that domestic welfare systems and the political composition of national governments are theorized to have on post-crisis social policy responses.

**Explaining Social Policy Variation**

**Welfare Systems**

Within comparative welfare state research, there is a rich literature on the significance of welfare regime types in explaining variations in social policy spending (Esping-Andersen, 1999; Häusermann and Palier, 2008; Pierson, 1996, 2001). According to this perspective, welfare institutions are important for several dimensions of social policy outcomes. First, the distinctive historical and institutional characteristics of a social protection system are argued to shape the
kinds of challenges a state faces after a crisis and define the strategies governments adopt in response to socio-economic changes (Scharpf and Schmidt, 2000). Second these institutions play an important role in structuring the debates, political preferences, and policy choices of actors within the state regarding social spending outcomes (Bonoli and Palier, 2000). Third, these institutions affect the different positions and influence of various stakeholders involved in the policymaking process. Different welfare system arrangements, therefore, influence the patterns of domestic conflict over social policy responses (Palier and Thelen, 2010).

The literature on comparative welfare states, following the influential work of Gøsta Esping-Andersen, identifies several distinct social welfare regimes in Europe: Nordic, Continental, Southern, Eastern, and Liberal. One advantage of this typology is that by focusing on the institutional aspects of the social protection systems it provides a framework for identifying broad cross-national differences (Palme, 2009, 19). While the institutional complexity that exists across states makes any attempt to categorize different models of social protection a process of simplification, such typologies offer a useful starting point for social policy analysis (Palme, 2009, 19). Empirical data and policy analysis provide some confirmation of the existence of distinct social protection systems across advanced capitalist states that conform to these five types. In their research on the automatic stabilization mechanisms of different welfare systems, Dolls, Fuest, and Peichl utilize hierarchical cluster analysis to group countries that have similar institutional responses to crisis events (Dolls et al., 2009, 2010). Their findings indicate that state responses to income and employment shocks cluster in accordance with the welfare state categories described.

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In *Three Worlds of Welfare Capitalism*, Esping-Andersen uses the categories Liberal, Corporatist-Statist, and Social Democratic to differentiate welfare types. Additional typologies have been added for Southern and Eastern European welfare systems which constitute separate distinct categories. It is important to note that no welfare system corresponds with the ideal type, but rather represents a complex mix of policy goals and institutional arrangements. However, these welfare types serve as a useful heuristic to conceptualize differences across advanced states.
above (Dolls et al., 2009, 20). Utilizing a similar hierarchical cluster analysis technique, Castles and Obinger examine the policies and politics of 25 OECD states to determine whether they constitute distinct welfare regime types (Castles and Obinger, 2008). Their findings confirm the existence of distinct public policy clusters of Nordic, Liberal, Continental, Southern, and Eastern welfare regimes (Castles and Obinger, 2008, 336). These scholars argue that not only do these clusters of welfare regimes with distinctive social policy arrangements exist, they have become more pronounced over time (Castles and Obinger, 2008, 321). That is, cross-national policy differences have not diminished despite increased globalization and Europeanization (Castles and Obinger, 2008, 326). This research helps to confirm the validity of utilizing distinct social welfare regime types in cross-national analysis.7

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7 For further studies on comparative welfare system clustering see (Esping-Andersen, 1990; Castles and Mitchell, 1992; Starke et al. 2008)

* Greece data missing for the year 1980; Portugal data only available for years 1996-2007; Spain data only available for years 1983-2007; Switzerland data only available for years 1983-2007

Source: Social Welfare Generosity Scores taken from the *Comparative Welfare Entitlements Dataset* (Scruggs et al., 2014). The dataset provides a welfare generosity index score using systematic data on institutional features of three social protection programs (Unemployment Insurance, Sick Pay Insurance, and Public Pensions) across 33 OECD countries.

It is useful at this point to briefly examine each welfare regime type to understand how their social systems are structured and to identify the ways in which they differ from one another. This comparison will help to explain the political conflicts which arise within these systems and the different crisis management responses that are generated.
Nordic Welfare Systems

In general terms, Nordic welfare systems are distinguished by their generous and universal welfare benefits and by high levels of taxation to fund costly social expenditures. These states are notable for their low levels of poverty, income disparity, and gender inequality. Nordic welfare systems have very high employment rates, in part due to large public sectors and activation policies (Häusermann and Palier, 2008, 569). The scope of public policy is also quite comprehensive with the state exercising a larger role in social service provision than in most other countries (Kvist 1999, 232). There also exists a high level of political cohesion among a wide range of constituents within Nordic welfare states (Häusermann and Palier, 2008). In fact, many of the social spending changes that have taken place across Nordic states have been adopted with widespread support from trade unions, government officials, and private employers (Häusermann and Palier, 2008, 570). As a result, these regimes have largely been able to avoid some of the political divisions that are seen in other welfare systems.

Due to the large size of the social protection system, Nordic welfare states have strong automatic stabilizers which provide increased spending support to citizens during times of economic crisis (Starke et al., 2012, 6). Since these counter-cyclical welfare responses are automatic and do not require political action, they are able to circumvent some of the contentious political debates that can arise over proposed increases in discretionary social spending (Starke et al., 2012, 22). It is important to note however, that short-term increases in the public deficit may place a significant burden on states, resulting in a desire for reduced social spending in the medium- and long-term. The financial strain of welfare increases is likely to be more pronounced in Nordic states, even compared with other large welfare systems, such as those in Continental Europe, due to the fact the majority of the costs of social spending in these countries is covered by
the government, rather than funded through individual contributions (Palme, 2009, 12). This process of trying to restrain welfare costs, however, has historically been less antagonistic in Nordic countries as political parties on the left and right have agreed on the necessity to cut social expenditures (Starke et al., 2012, 19). In the context of the current economic crisis, we might ultimately expect these regimes to be able to establish a broad base of support for social spending decisions representing a more consensual political process.

**Liberal Welfare Systems**

In contrast to Nordic welfare systems, Liberal welfare regimes are notable for providing lower levels of public services preferring instead to rely on market-based benefits. Means tested programs targeted towards at-risk populations, such as low income working class citizens, are common in these regimes, rather than universal benefits. Traditional political conflict within these systems has been characterized as a struggle between left-wing welfare supporters and opposing right-wing free market advocates. Since social transfers are granted to low income citizens, rather than provided through earned benefits, there tends to be lower levels of public support for increased social spending within these states. Lower income welfare recipients are generally less well represented within the political process and therefore less capable of advocating for the expansion of social benefits (Häusermann and Palier, 2008, 572; Taylor-Gooby, 2001). In other words, the working poor, low-skilled laborers, and the unemployed not only face increased social inequality, making them more reliant on welfare services, but are politically marginalized and less able to advocate for themselves. However, whereas rising income inequality remains a significant problem in Liberal welfare regimes, their high degree of labor market flexibility enables them to
avoid some of the insider-outsider divisions found in other welfare regimes (Iversen and Soskice, 2010, 20).

Although political conflict over social spending has traditionally fallen across party lines, in the contemporary context ALMPs have gained support across the political spectrum in Liberal welfare states. ALMPs are seen as social investment strategies to increase employment and shift welfare policies away from passive compensation towards workforce activation. In other words, these policies focus on improving individual opportunities, rather than on individual welfare rights. The result has been an important convergence of Conservative and Labor party political preferences regarding ALMP support (Häusermann and Palier, 2008, 571; Taylor-Gooby, 2001). Despite this cross-party support for employment-friendly social strategies, there may continue to be significant debate over the kinds of redistributive measures and the level of basic social benefits that should be provided to low-income and other at-risk groups. These disputes will likely fall along established political conflict lines between liberal parties, favoring greater poverty prevention initiatives for the working poor and policy instruments of wage equalization, and conservative parties, favoring welfare reductions and focused on labor market efficiency. In sum, in the post-crisis period we might expect to see limited support for overall social spending increases and the persistence of left-right political divisions across many policy areas.

**Continental European Welfare Systems**

Continental European welfare regimes have long favored wage equality and employment protection over full employment strategies (Iversen and Wren, 1998). These welfare regimes typically offer high levels of protection and wage coordination for standard employment, while at the same time penalizing non-standard work. Employment protection for core workers limits labor
market access to outsider groups, especially low-skilled workers, thereby limiting labor market flexibility and worsening conditions for outsider groups (Iversen and Soskice, 2010, 3). This creates a significant divide between labor market insiders who are provided with adequate social insurance and outsiders who do not have access to the same welfare provisions.

Additionally, Continental regimes are predicated historically on a male breadwinner institutional model, which offers few family support structures, resulting in lower levels of female workforce participation. Overall, low labor market participation has created a significant problem for many states as social security measures are typically provided through insurance schemes funded by payroll taxes (Häusermann and Palier, 2008, 570). This insider-outsider divide is central to the politics of social policy spending in these welfare regimes (Rueda, 2007). In the post-crisis period, we should expect that the political dynamics of Continental welfare regimes will pit core workers, who seek to protect their existing social benefits, against part-time and irregular employees seeking greater access to social provisions. This may result in limited support among labor market insiders for social spending increases that target marginalized outsider groups.

**Southern and Eastern European Welfare Systems**

While constituting distinct welfare regime types, Southern and Eastern European welfare systems are founded on a similar institutional model as that found in Continental welfare states. Consequently, these welfare systems face similar difficulties with labor market dualization and low levels of social solidarity. Regular workers benefit from strong employment protection and generous social provisions, while outsiders have limited access to social welfare benefits.

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8 The modern Continental welfare state owes much of its origins to the policies and institutions implemented by German Chancellor Otto von Bismarck during 19th century. The legacy of this type of welfare system is still prominent in the politics and policies of many states across Europe, including those in Eastern and Southern Europe.
Moreover, compared to Continental European welfare states, the social protection systems in Southern and Eastern European countries are much more limited (see Table 7), offering fewer social benefits and lower levels of protection for citizens against economic fluctuations. In particular, while Continental European welfare states provide significant automatic stabilizers that increase social spending during a crisis, the smaller welfare states in Southern and Eastern Europe lack such automatic counter-cyclical responses (Dolls et al., 2010, 16). As a result social policy decisions are subject to far more political debates and partisan divisions (Starke et al., 2012).

Although both welfare regimes face similar challenges, there are important distinctions which separate these two systems. Southern European welfare states are notable for their low levels of social assistance and strong reliance on the family as an informal source of welfare provision (Palme et al., 2009, 22). The family unit in Southern European states acts as both a source of social protection, through the provision of care and support, as well as a source of production, through the establishment of family businesses (Karamessini, 2007, 5). The core workforce predicated on a male breadwinner model enjoys high employment protection and job stability, while labor market outsiders, for example youth and women, face high unemployment rates and receive low levels of social protection (Karamessini, 2007, 5). As a result, dualization is more pronounced in these systems than in continental Europe. Reliance on the family as a source of economic growth has led to systems of clientelism and patronage networks across many sectors (Karamessini, 2007, 5). Compared with Continental European welfare states, the quality of social protection is also much lower across policy areas in Southern Europe. Unemployment benefits, health and sickness policies, vocational training, minimum wage benefits and other types of social assistance are often underfunded or absent in these regimes (Palme et al., 2009, 22). Old age benefits, however, are
fairly well developed and early retirement policies are frequently used as a way to address issues of unemployment (Palme et al., 2009, 22).

Eastern European welfare systems represents a distinct combination of social protection arrangements which are characteristic of the region’s history and development. These regimes have a strong corporatist tradition, similar to those found in the Continental European welfare regime type. This system was present in many countries, prior to Communist control and continues to have important influence in present day social policies, including pension systems, unemployment benefits, and labor market rules (Deacon, 1997; Golinowska et al., 2009; Offe, 1993; Potůček, 2009). The importance of the Continental model is evident in the post-Communist goals of these welfare states. The prevailing logic of these welfare systems since independence has been to protect individual employment and wages, rather than aim to reduce income inequalities (Palme, 2009, 22). Institutional structures to address issues related to unemployment were essentially non-existent in these regimes during the Soviet era and new institutions and policies had to be adopted to address these concerns as states adjusted to a new market based economy (Elster et al., 1998). Unlike Continental regimes, however, Eastern European welfare systems exhibit more universalistic tendencies reflecting the high degree of coverage that existed under the Soviet system (Aidukaite, 2011; Potůček, 2009). Another important feature of the Eastern European welfare model is the liberalization of social and economic policies beginning in the early 1990s. After the collapse of the Soviet Union, Eastern European states began to transition towards democracy and market based economies. During this time, considerable efforts were made to liberalize various aspects of the Eastern European welfare systems, changes that coincided with broader economic restructuring. However, these liberal reforms did not constitute a wholesale dismantling of the welfare state or the convergence toward a liberal model (Aidukaite, 2011;
Potůček, 2001, 2009; Saxonberg and Sirovátka, 2009). By the start of the global financial crisis, Eastern European welfare states were much smaller, offering fewer social benefits and lower levels of protection, particularly in the areas of healthcare and unemployment, than their counterparts in Continental and Northern Europe (Eurostat, 2015; Palme, 2009).

Ultimately, each of these systems of social protection play a role in mediating political conflict within states in ways that are particularly relevant in shaping national crisis management responses. Welfare state funding and policy access play an important role in defining the lines of political conflict. Welfare states that provide high levels of employment protection, but limited access to social provisions can generate conflict between labor market insiders and outsiders not granted the same benefits (Häusermann and Palier, 2008; Rueda, 2007, 2014). This type of political conflict is problematic within Continental, Southern, and Eastern European welfare regimes to varying degrees. In contrast, welfare systems providing universal rather than earned benefits do not face the same problems of dualization. Nordic welfare states in particular have high degrees of social solidarity, but are faced with the dilemma of containing the high costs of expensive social policies. The result may be pressure to reduce government expenditures in the medium- and long-term, although through a more consensual political process. Finally, Liberal regimes, which operate under a model of low levels of means-tested welfare provisions combined with flexible labor markets avoid the dualization that exist in other regimes but face problems of rising income inequality and divisions between underrepresented low income groups, who are recipients of direct state assistance, and middle- and upper-income groups with greater political representation and access to benefits through the market (Häusermann and Palier, 2008).

In addition to important differences generated by the type of social policy provision, whether means-tested, earned, or universal, the size of the welfare state serves as an important
intermediary between political conflict and social policy outcomes. In large welfare states, a great deal of crisis management relies on sizeable automatic stabilizers that expand social spending without need for political debate (Cohen and Follette, 2000; Dolls et al., 2010). In other words, political questions about social policy expansion versus retrenchment may not even enter the agenda, or at least to a lesser extent in wealthier welfare states, and partisan conflict may be more muted (Starke et al., 2012, 6). We should expect for the adjustment of specific social policy instruments in Continental European and Nordic states, therefore, to be achieved in a relatively consensual and depoliticized manner (Starke et al., 2012, 22). In contrast, crisis management in smaller welfare states relies less on automatic stabilizers and more on discretionary spending. As a result, there is a greater likelihood that the social spending response of states with small welfare systems will be more conflictual and subject to partisan struggles (Starke et al., 2012, 22). Examples of this type of highly polarized debate over the effectiveness of social policy measures can be found post-crisis in a number of countries, including Spain and Greece.

Ultimately, the role that welfare systems play in defining and arbitrating political conflict is extremely important in the post-crisis time period. The data presented in chapter 3 provides compelling evidence that the political determinants of social spending outcomes became far more pronounced following the global economic crisis. As a result, welfare state institutions take on an even more significant role in shaping domestic political dynamics and policy outcomes in the post-crisis timeframe. Evidence in chapter 3 also indicates that the institutional effects of social protection systems on welfare spending were also significantly altered by the crisis.
Electoral System and Political Parties

In addition to the structure of domestic social protection systems, comparative welfare state literature points to the importance of electoral systems and the political composition of national governments in shaping levels of social spending and government responsiveness (Huber et al., 1993; Iversen and Soskice, 2006, 2010; Van Kersbergen, 1991). According to this perspective, differences in electoral institutions and political party composition generate different coalitions across states which in turn produce systematically different policy responses to social and economic challenges. Electoral systems play a key role in shaping the governing coalitions within states thereby influencing domestic redistributive polices (Iversen and Soskice, 2006). The central argument is that the electoral system, and the presence or lack of a strong Christian democratic (CD) party in the case of a proportional representation (PR) electoral system, will affect government social policy responses to economic shocks (Huber et al., 1993; Iversen and Soskice, 2006, 2010).

In order to understand how these political institutions shape social spending, it is important to understand the influence that different electoral systems have on policy outcomes. Majoritarian electoral systems it is argued favor center-right political coalitions, which are more representative of middle and upper-middle class interests and are less supportive of redistributive measures (Iversen and Soskice, 2006, 2010). PR systems by contrast tend to favor center-left coalitions, which favor a larger welfare state and greater redistributive policies that compensate low-skilled workers (Iversen and Soskice, 2006, 2010). In sum, the expectation is that states with PR electoral systems should be more responsive to economic shocks, in terms of increased social spending, than states with majoritarian systems.

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9 For additional literature on the influence of Christian Democratic parties versus Social Democratic parties on social spending outcomes see (Van Kersbergen 1991; Huber et al. 1993).
The literature also identifies political parties as a second significant variable affecting national social policy responsiveness (Iversen and Soskice, 2006, 2010). In other words, the type of governing political party can generate different social spending outcomes even between states with the same electoral system. PR systems without a strong CD presence are argued to be more aligned with labor and the interests of both insider and outsider groups. The result is a more inclusive political system, which promotes higher levels of social solidarity, universal welfare benefits, and broad support for social spending (Iversen and Soskice, 2010, 12). In contrast, PR systems with a strong CD party tend to create coalitions across the political center which effectively exclude outsider groups in unprotected labor market positions (Iversen and Soskice, 2010, 12). This translates into limited political support for social spending for outsider groups.

These arguments tie in with power resource theories that claim that variations in welfare state outcomes can be explained by distributive conflicts between political parties, which reflect different socio-economic groups (Esping-Andersen, 1985, 1990; Huber & Stephens, 2001; Korpi, 1983, 1989, 2003; Korpi and Palme, 2003; Myles, 1984). Ruling parties, therefore, are expected to exercise an important influence over social spending outcomes (Aidukaite, 2009). From this perspective, countries with strong left-wing parties, for example Social Democrats or Labour, should be correlated with more generous levels of social spending than those with a significant conservative party presence (Esping-Andersen, 1990; Hicks et al., 1995; Huber and Stephens, 1996; Korpi, 1983, 1989; Quadagno, 1987; Smelser, 1994). In sum, divergent redistributive policies are argued to reflect cross-national differences in the political institutions within states and the governing coalitions that they give rise to (Iversen and Soskice, 2010, 20).

While much of the literature on political institutions and parties addresses the post-industrial economic and demographic challenges that advanced states have faced in recent years,
this research has not been applied to the current economic crisis. In the aftermath of acute financial shock, we should expect political conflict to become heightened. As a result differences in electoral systems and political party control of government are expected to have greater influence in shaping the crisis management and social policy response of national governments. At the same time, welfare institutions will play an important mediating role in defining the political dividing lines and degree of politicization across states. Political variables and welfare institutions, therefore, offer important and complimentary explanations for understanding the divergent responses of advanced welfare states to the global economic crisis.

**European Union Influence**

Finally, whereas much of the comparative welfare state literature examines the effects of domestic level political variables on social policy outcomes, little attention has been given to the influence of EU institutions and policies on welfare state spending. By failing to incorporate the potential influence of European level variables, explanations of national social policy response may miss a potentially important explanatory factor. By examining variables for EU influence on domestic social policy spending, this research will address whether social spending in member states has been influenced by EU institutions and policies.

There are several reasons to expect that European level variables might be important in the post-crisis period. First, the crisis has led to changes in EU economic governance, with significant spillover effects in other social policy areas. Greater fiscal policy integration at the European level has placed serious constraints on domestic social spending levels. The 2012 European Fiscal Compact, for example, established significant limits on the amount of domestic spending a state can undertake by requiring members signing onto the treaty to implement a balanced budget rule
in their national legislation as a permanent binding provisions (European Commission, 2012). This may limit government responsiveness in terms of social spending policies to address rising unemployment and inequality.

Second, the post-crisis period has seen a renewed effort on behalf of European authorities to promote employment and prioritize social investment strategies, such as ALMPS, through initiatives including Europe 2020. Europe 2020 identifies social inclusion, youth employment, increased female participation, and promoting a highly skilled labor market as vital across Europe (Heyes, 2013; Kvist, 2013). Its goal is to establish a European space for social policy coordination through policy learning and feedback, along with the establishment of common goals. The idea is to create a flexible framework for member states to pursue common social policy objectives, such as reducing social inequality and ensuring a basic standard of living for all citizens. Moreover, the concept of a European Social Model emphasizes the desire of the Commission to place social objectives high on the EU agenda (Palme, 2009, 15). In other words, the focus is for EU member states to not only establish competitive knowledge-based economies, but also to maintain strong commitments to social inclusion and equality. EU institutions and policies are, therefore, likely to be important variables in explaining patterns of social spending across European states in the post-crisis period.

Conclusion

The existing comparative welfare literature offers important complimentary explanations for social spending variation across countries. These political and institutional variables offer important insights into what drives social spending under normal economic conditions. Little
research, however, has examined how well these variables account for social spending responses in the aftermath of the global economic crisis. More research, therefore, must be conducted to explore how these variables shape post-crisis social spending patterns. Using panel data models, the next chapter will explore what effects each of these variables have on social spending across states in the timeframe prior to the global economic crisis and in the period after the start of the Great Recession. This statistical analysis offers some surprising results on the how these political and institutional factors shape national crisis management responses. Most notably, the statistical findings indicate that, contrary to the expectations within the literature, that domestic electoral systems and political coalitions only gained significance at the onset of the crisis.
Chapter 3: Methods and Quantitative Data

To understand the effects of the global economic crisis on advanced welfare states, it is important to examine how this event has reshaped the factors driving social spending across countries. The comparative welfare state literature has identified several theoretically significant variables hypothesized to influence domestic social spending levels. These include European level variables, such as EU membership and specific EU policies, as well as domestic factors including welfare system arrangements, electoral institutions, and political party control of government. These political and institutional variables provide important explanations for post-crisis variations in the social spending responsiveness of national governments. While many of these factors may have been important in defining levels of social spending in the pre-crisis period, I argue that their effects have been significantly altered in the wake of the global economic crisis. This chapter will examine the effects of the crisis on different social welfare explanatory variables and test the utility of each of these factors in explaining national social spending levels in the pre- and post-crisis periods.

Methodology and Model Explanation

Panel data analysis will be used to test the effects of political and institutional variables on social spending changes. In particular, a hierarchical linear statistical model will be employed to analyze the patterns of government response to the economic shock of the global financial crises. To do so, the model estimates the effects of economic changes on policy variables, while differentiating the intervening effects that institutional variables have on the strength and direction of these changes (Iversen and Soskice, 2010, 15). This model accounts for country-level variation, thereby revealing differences in government responses over time. The economic shock of the crisis
is assumed to be common across countries. In other words, all countries are expected to experience similar pressures over the same period of time (Iversen and Soskice, 2010, 15). The model includes data for 28 OECD countries over a 24 year timeframe from 1990 until 2013. This allows for greater explanatory power of social spending patterns across a wide range of advanced industrialized states and the varied impact the crisis had across countries.

An interaction variable is included in the model for each independent variable of interest to determine what effect these factors have on social spending during the pre-crisis (1990-2007) and post-crisis (2008-2013) periods. This will provide statistically significant evidence of the impact of the crisis on social spending responses and allow me to test whether the same independent variables remain statistically significant in both periods. For those variables which remain significant, an examination of pre- and post-crisis data will reveal what direction these factors have on public social spending. A metric measure will also be used to determine the magnitude of these effects in both periods. This is important as it allows the model to differentiate between variables which remain significant in both periods to determine whether they are having a stronger or weaker effect on the dependent variable in each timeframe.

**EU Variables**

Even as a great deal of European welfare state literature focuses on the influence that national level variables play in explaining social policy changes, there is a strong expectation that EU institutions and policies influence the social spending outcomes of member states. This is particularly important in the post-crisis period as EU authority over fiscal policy has expanded and member state expenditures restricted. For example, although national governments retain control over the *kinds* of social welfare measures they provide to their citizens, the 2012 European Fiscal
Compact places significant limits on the amount of domestic spending a state can undertake. Under this treaty, the annual structural government deficit of a member state must not exceed 0.5% of GDP (European Council, 2012; European Commission, 2012). The crisis, therefore, has not only affected states directly in economic terms, but has also led to changes in EU governance with significant spillover effects in social policy areas. In addition to increased fiscal policy control at the European level, the EU has taken up a number of social initiatives, most prominently Europe 2020, with the objective of increasing social investment in member states and promoting a highly skilled European labor market (European Commission, 2010b). The goal of this policy is to establish a European space for social policy coordination through policy learning and feedback, as well as, the establishment of common goals for all members using the Open Method of Coordination.\(^\text{10}\)

I include several European level variables in my statistical model to test the influence of EU institutions and policies on social spending levels across member states. They include the effects of EU membership and Eurozone membership on government social spending. Data will be used from several OECD countries that are non-EU and non-Eurozone members to account for the effects of membership. The model also includes the adoption of two EU policies to determine whether these specific European agreements have shaped member state social spending levels. First, the adoption of the 2012 European Fiscal Compact will test whether the fiscal limits placed on public debt and deficit levels has affected government responsiveness to the ongoing economic crisis. Second, the inclusion of a variable for the adoption of Europe 2020 will test whether the

\(^{10}\) According to the EU the open method of coordination, "provides a new framework for cooperation between the Member States, whose national policies can thus be directed towards certain common objectives. Under this intergovernmental method, the Member States are evaluated by one another (peer pressure), with the Commission's role being limited to surveillance. The European Parliament and the Court of Justice play virtually no part in the OMC process." Further information available at: http://europa.eu/legislation_summaries/glossary/open_method_coordination_en.htm
agreement, which seeks to increase social investment strategies, has had a statistically significant effect on member state social spending.

Welfare Systems

In addition to examining the influence of European level variables, it is also important to identify and include domestic variables theorized to effect government social spending responsiveness. According to welfare capitalism literature, welfare regimes play an important role in defining the social policy outcomes of different states. These institutions define the types of social policies adopted by states, the levels of social spending, and the structure of political divisions within countries (Esping-Andersen, 1999; Thelen 2012, 150). According to this logic, political debates over social policy spending are heavily influenced by the welfare institutions within states. Increased dualism in Southern European welfare regimes and subsequent political conflict, for example, are argued to be a product of welfare institutions which provide high levels of social benefits and strong job security to labor market insiders who mobilize to protect their rights (Rueda, 2007; Emmenegger et al., 2011). To test this argument an independent variable has been incorporated into the model to examine the effects of welfare regime type on policy outcomes. A dummy variable has been introduced which includes distinct categories for each welfare regime type identified in the previous chapter: Nordic, Liberal, Continental, Southern, and Eastern. This will allow the model to differentiate between the possible effects that these different welfare systems have on social spending levels in both the pre- and post-crisis periods.

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11 Welfare regime types for this variable coincide with existing comparative welfare literature ideal types. Research utilizing hierarchical cluster analysis provides evidence for the existence and utility of these welfare regimes types in explaining cross-national differences between social protection systems. For further information see (Castles and Obinger 2008; Dolls et al. 2009; Palme 2009).
Electoral Institutions and Political Parties

It is also important to introduce a second set of domestic independent variables into the model to account for the effects that electoral institutions and political party control of national governments have on social spending outcomes. First, a dummy variable has been introduced for electoral type that differentiates between states with proportional representation (PR), mixed, or majoritarian electoral systems. The hypothesis here is that majoritarian electoral systems will favor center-right political coalitions, which support lower levels social spending (Iversen and Soskice, 2010, 12). In contrast, PR electoral systems will tend to favor center-left coalitions which support higher levels of social spending (Iversen and Soskice, 2006, 2010). Mixed electoral systems incorporate features of both a majoritarian and PR electoral and should be expected to fall in between these two other systems resulting in modest social spending levels. A second variable has been introduced to differentiate between electoral systems with a strong Christian democratic (CD) party presence and those without. According to the comparative politics literature, a strong CD presence should be correlated with lower levels of social spending. It is argued that these parties tend to favor centrist and right leaning coalitions which effectively exclude outsider groups seeking to increase social spending levels (Iversen and Soskice, 2010, 12). In contrast, electoral systems without the presence of a strong CD party result in more inclusive political coalitions that promote higher levels of social expenditures (Iversen and Soskice, 2010, 12). A threshold of voter share above 15% is used as a measure of strong CD presence. These independent variables capture the important effects that electoral institutions and political parties may have on social policy outcomes.
Control Variables

In addition to the independent variables of interest identified above, several standard control variables are included in the panel data model to account for their effects on social spending. Including these variables allows the model to account for the effects of these controls and to isolate the specific influence that each independent variable of interest has on national social spending responsiveness. For example, while a change in the unemployment rate might generate counter-cyclical social spending, holding the effects of this control variable constant enables us to account for its influence on social spending and identify the effects of other variables of interest, such as EU and non-EU membership. In other words, we can account for the effects of control variables, such as domestic unemployment rates, when considering the influence of each of the independent variables of interest on social spending outcomes.12

**GDP per capita:** This measure accounts for Wagner’s law which posits that public social spending is income elastic. In other words, that there is a positive correlation between the social spending levels and per-capita GDP within a country (Iversen and Soskice, 2010; Lamartina and Zaghini, 2011). This variable also helps to account for the differences in the degree of economic downturn faced by citizens in various countries.

**Economic openness:** This variable is a measure of the value of exports plus imports as a percentage of GDP for a given country. The inclusion of this variable accounts for the hypothesis that states that are more integrated into international markets will generate greater demand for social spending (Cameron, 1978; Garrett, 1998; Rodrik, 1999). This

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12 See Appendix for more detail about the independent, dependent, and control variables.
measure helps to account for differences in the amount of exposure to international markets faced that different countries had both before and after the crisis.

**Unemployment Rate:** While there is an expectation that higher levels of unemployment will be correlated with more generous unemployment spending, this research is concerned with the effects of economic shock on social spending generosity across states. Incorporating this control variable into the model will help to differentiate the effects of political and institutional variables on social spending responsiveness from increases associated with rising unemployment levels (Iversen and Soskice, 2010).

**Female labor force participation:** This variable accounts for the effects that female participation in the labor market has on demands for increased social spending. The argument is that female workforce participation is positively correlated with public funding of social services. By including this control variable the model can account for the effects that women's labor force participation has on the expansion of public social welfare services (Huber and Stephens, 2000).

**Dependent population size:** In order to account for the effects of changing demographics, variables have been introduced to account for the size of working and non-working populations as a percentage of the total population. Identifying measures of the population (under 15 years of age) and the population (over 65 years of age) will help to control for the effects that the size of non-working population may have on public demands for increased social spending. The size of the retired population (typically individuals age 65
years and older) may create pressure for increased social spending in a number of areas such as pensions (Iversen and Soskice, 2010).

**Voter turnout:** This variable has been included to account for the effects that voter turnout has on social spending outcomes. The argument is that higher voter turnout is correlated with more responsive social spending due to the fact that as turnout increases the median voter typically becomes poorer relative to mean income (Kenworthy and Pontusson, 2005). In other words, the higher the voter turnout the greater the number of low income constituents, who are more likely favor greater redistributive measures and social spending increases, are represented.

**Statistical Model**

\[
S_{i,t} = (1 + \beta^{PR} * PR + \beta^{CD} * CD + \beta^{EU} * EU + \beta^{EMU} * EMU + \beta^{EU20} * EU20 + \beta^{FC} * FC + \beta^{W} * W) * (\Sigma \delta_t * D_t) + \Sigma \gamma_k X_{i,t} + \lambda + \alpha_i + \epsilon_{i,t}
\]

\(S_{i,t} = S\) refers to government spending in some policy area, \(i\) indexes countries, \(t\) time period

\(k = k\) a set of control variables (\(X_{i,t}\))

\(D_t = \) Annual time dummy variable used to signify common economic shocks

\(PR = \) Proportional Representation

\(CD = \) Christian Democratic Party

\(EU = \) EU Membership

\(EMU = \) European Monetary Union Membership

\(EU20 = \) Europe 2020 Adoption

\(FC = \) Fiscal Compact

\(W = \) Welfare Regime Type

\(\beta = \) The key parameters are the betas because they capture the extent to which political-institutional differences mediate the effects of common unobserved shocks on spending. For example, if there are no institutional effects then \(\beta^{PR} = \beta^{CD} = 0\) and policies are entirely a function of the control variables plus the set of time and country-specific effects.

\(\alpha_i = \) Unobserved case specific effects

\(\epsilon_{i,t} = \) Unobserved random error term
Hypothesis Testing

There are several different results that this model may yield, each of which will tell us important information about the effects of the global economic crisis on welfare states and the factors which shape social policy responsiveness in the post-crisis period.

Hypotheses

\( H_0 \) = The null hypothesis is that there has been no change in the statistical significance, the magnitude of effect, or the direction of effect of any given independent variable in the pre- and post-crisis periods.

Significance: If the model yields this result it indicates that despite the seemingly significant effect of the economic crisis, welfare state responsiveness has in fact not been altered by this event. This provides an important answer as to whether or not acute financial crises affect the social spending responsiveness of welfare states.

\( H_1 \) = An independent variable which was statistically significant in explaining social spending in one period is no longer significant in another.

Significance: This would provide a strong indication that the crisis has had a significant effect and fundamentally altered the relationship between a given explanatory variable and the dependent variable.
\( H_2 = \) An independent variable is statistically significant in both periods, but the magnitude of its effect has changed.

*Significance:* This finding would suggest that while an independent variable is statistically significant in both periods, its effects on the dependent variable are more pronounced in one of timeframes. In this case, the global economic crisis has altered the influence of the independent variable on the dependent variable by making its effects either stronger or weaker.

\( H_3 = \) An independent variable is statistically significant in both periods, but the direction of the effect has changed.

*Significance:* This finding would suggest that while an independent variable is statistically significant in both periods, the effect it is having on the dependent variable has reversed. For example, whereas an explanatory variable might be associated with increased social spending pre-crisis it becomes associated with social spending cuts in the post-crisis period.

**Overview of Findings**

Based on the results of the panel data analysis, it is clear that the global economic crisis has had an important influence on the social spending of advanced industrialized states. In the post-crisis period the effects of political and institutional variables were greatly altered indicating that the crisis has had effect on dynamics national social spending. On average, the crisis generated higher levels of overall social spending across OECD countries and was correlated with increased
funding for unemployment, health, and family policies. In addition to the general affect that the crisis had on social spending across OECD states, it is clear from the findings, that not only are EU level variables, welfare systems, and domestic political factors significant in shaping social spending outcomes, but the effects that these variables have on social policies has been considerably transformed by the 2008 crisis (See Table 8).

### Table 8. Regression Results for Selected Variables

<table>
<thead>
<tr>
<th></th>
<th>Total Social Spending</th>
<th>Unemployment</th>
<th>ALMPs</th>
<th>Health</th>
<th>Family</th>
<th>Old Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post-crisis</td>
<td>1.07**</td>
<td>0.32*</td>
<td>0.72*</td>
<td>0.26***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU Pre-crisis</td>
<td>-1.90*</td>
<td>-0.18***</td>
<td>-0.18*</td>
<td>-0.44*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU Post-crisis</td>
<td>-0.75*</td>
<td></td>
<td>0.61**</td>
<td></td>
<td>0.94*</td>
<td></td>
</tr>
<tr>
<td>EMU Pre-crisis</td>
<td></td>
<td></td>
<td>0.17</td>
<td></td>
<td>0.24***</td>
<td></td>
</tr>
<tr>
<td>EMU Post-crisis</td>
<td>1.13**</td>
<td>0.65*</td>
<td></td>
<td>-0.14***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU Fiscal Policy</td>
<td>-1.11*</td>
<td>-0.26*</td>
<td>-0.09</td>
<td></td>
<td>0.34**</td>
<td></td>
</tr>
<tr>
<td>Europe 2020</td>
<td></td>
<td></td>
<td>0.22**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nordic Pre-crisis</td>
<td>7.38*</td>
<td>1.28**</td>
<td>0.80*</td>
<td>1.36*</td>
<td>2.27***</td>
<td></td>
</tr>
<tr>
<td>Nordic Post-crisis</td>
<td>-3.95*</td>
<td>-0.55**</td>
<td>-0.29*</td>
<td>-0.91*</td>
<td>-0.65*</td>
<td>-0.99*</td>
</tr>
<tr>
<td>Continental Pre-crisis</td>
<td>7.92*</td>
<td>1.09**</td>
<td>0.40</td>
<td>1.69*</td>
<td>1.14*</td>
<td>2.78**</td>
</tr>
<tr>
<td>Continental Post-crisis</td>
<td>-0.91</td>
<td>0.29***</td>
<td></td>
<td>-0.96*</td>
<td></td>
<td>0.41***</td>
</tr>
<tr>
<td>Southern Pre-crisis</td>
<td></td>
<td></td>
<td>0.49**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southern Post-crisis</td>
<td>-2.15*</td>
<td>-0.34***</td>
<td>-1.15*</td>
<td>-0.56**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eastern Pre-crisis</td>
<td>4.12**</td>
<td>-0.85</td>
<td>0.83*</td>
<td>0.77***</td>
<td>2.87**</td>
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<tr>
<td>Eastern Post-crisis</td>
<td></td>
<td>0.61*</td>
<td>-0.94*</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PR Pre-crisis | -0.23*** | -0.59* | -0.47
---|---|---|---
PR Post-crisis | 1.89* | 0.39** | 0.18** | 0.36***
Mixed Pre-crisis | -0.80 | -0.21** | -0.80*
Mixed Post-crisis | | -0.32 | -0.42***
CD Strong Pre-crisis | | | -0.26
CD Strong Post-crisis | -3.24* | -0.43* | -0.52** | -0.73*

* significant at .001 level; ** significant at .01 level; *** significant at .05 level

Note that control variables have not been included in this table (for complete regression tables see Appendix II).

**EU Level Influences on Social Spending**

One of the most compelling findings from the data are the changes in the statistically significant effect that EU membership has had on social spending outcomes. While European welfare states historically has been notable for high levels of social spending, it appears that the period building up to the crisis represents an era of welfare state retrenchment across Europe. EU membership during this time was correlated with average social spending cuts of 1.90 percent of GDP (See Table 9). In many respects, this timeframe reflects a period of fiscal austerity, shifting demographics, and labor market changes which have been a common challenge for European welfare institutions. The social and economic policies in the pre-crisis timeframe were also heavily shaped by prevailing neoliberal beliefs encouraging reductions in welfare state spending. In the post-crisis period, however, this pattern of social policy retrenchment came to a halt as EU members began to adopt social spending levels in line with other advanced welfare states. In addition to average overall social spending being on par with other OECD states, EU membership was correlated with increases in health and old age spending increases, perhaps reflecting the
growing needs of aging populations. EU membership, however, was also correlated with an average decrease of 0.75 percent of GDP in the area of unemployment policies in the post-crisis period.

Another noteworthy finding is that while the social spending of Eurozone members was not significantly different than that of other EU members in the pre-crisis period, post-crisis Eurozone states were far more responsive to economic shocks and were correlated with average increases in overall social spending by 1.13 percent of GDP and unemployment spending by 0.65 percent of GDP (see Table 9). However, as EU members who do not belong to the currency union began to increase spending on ALMPs to the levels of other advanced welfare states post-crisis Eurozone members began to cut back on social spending in this policy area. This may reflect some of the dualization and insider outsider divisions that exist within many of the Eurozone states. Ultimately, these data indicate an important distinction post-crisis between European countries that are members of the currency union and those who are on the outside. In short, there is a noticeable difference between the social policy responsiveness of EU and Eurozone members in the aftermath of the economic crisis.

The data also indicates the important effects that specific EU policies had in affecting social spending outcomes. As hypothesized, the 2012 *European Fiscal Compact* is correlated with significant cut backs in overall levels of social spending across EU member states, with government expenditures on average at -1.11 percent of GDP. This EU fiscal policy change is also correlated with social spending retrenchment in several specific policy areas including unemployment, ALMPs, and health provisions (See Table 9). This finding seems to confirm the expectation that austerity measures associated with *European Fiscal Compact* have constrained
public spending across EU member states. This measure was also associated with retrenchment in certain specific social policy areas as well.

Despite efforts to create harmonized policies and promote social spending, it appears that Europe 2020 has had few statistically significant effects on most social spending policy areas (see Table 9). However, the policy has been associated with a slight increase in average unemployment spending across member states. This result corresponds with the stated objectives of Europe 2020, which focuses on reducing unemployment and increasing skilled labor force in Europe. It is surprising, however, that the policy was not correlated with increased ALMP spending as these types of social investment strategies were a key piece of the legislation (European Commission, 2010b). Ultimately, it is clear from the data that not only are EU level variables statistically significant in explaining social spending patterns across member states, but that the global economic crisis reshaped these patterns in important and surprising ways.

Table 9. EU Level Influences on Social Spending

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<td>Social Spending as % GDP</td>
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<td>eu</td>
<td>eu fiscal</td>
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<td>-2</td>
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<tr>
<td>-1.5</td>
<td>-1</td>
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<tr>
<th>Unemployment Spending as % GDP</th>
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<td>eu</td>
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Note that these graphs only show the effects of variables which were statistically significant in either or both the pre- or post-crisis periods.

Welfare State Influences on Social Spending

In addition to European level consequences, the crisis also had a significant effect on the influence of political and institutional variables at the domestic level. Based on the data it is clear that welfare institutions had statistically significant effects on the social spending of different states in both the pre- and post-crisis periods. The effects of these institutions on social spending outcomes, however, have been notably different in each timeframe. In some cases, a welfare regime which was statistically significant in explaining social spending levels in one period was no longer significant in another (Hypothesis 1). In other cases, a welfare regime type was statistically significant in both periods, but the magnitude of its effect changed as a result of the crisis (Hypothesis 2). Finally, in a few cases a welfare system associated with increased social
spending in one period was correlated with retrenchment in the other time frame (Hypothesis 3). Overall, this indicates that there is important variation in how different welfare systems respond to the economic shocks caused by the international financial collapse. It also suggests that we can reject the null hypothesis that the influence of different welfare systems on social spending levels has not been altered by the crisis. In order to understand the impact of this crisis we must examine the social spending patterns of each regime type in the post-crisis period.

**Liberal Welfare Systems**

Since the welfare institutional categories introduced in the panel data model are dummy variables, the Liberal welfare systems has been used as the reference point for all other welfare regimes. The data indicates that overall social spending as a percent of GDP has been higher in Continental and Nordic welfare systems than in liberal regimes in both the pre- and post-crisis periods (See Table 10). This finding is unsurprising as liberal welfare systems tend to provide more modest means tested types of social support relying more on market mechanisms, rather than government interventions to respond to changing economic conditions. Unemployment spending within liberal welfare systems remained higher than in Eastern European regimes in the pre-crisis period and was higher than both Southern and Eastern European regimes post-crisis. This may reflect both the maturity of these regimes, which were established much earlier, as well as the need for liberal regimes to implement some unemployment measures to address rising social inequality. Whereas social spending on ALMPs had been higher in Continental and Nordic systems pre-crisis, only Nordic regimes were associated with higher spending in this policy area post-crisis. Despite having lower total social spending than Continental and Nordic systems, it is not unexpected that ALMP spending within liberal welfare systems was comparable to those of other systems. ALMPs
represent a more liberal market based approach to addressing increases in unemployment, as they focus more on workforce activation, rather than passive unemployment assistance. Whereas Old Age spending was notably higher in Continental and Eastern European welfare systems pre-crisis, spending in this social policy area was indistinguishable from that of liberal systems post-crisis. This may reflect the large burden that old age expenditures have on welfare states and the need to reduce social spending on these policies across systems post-crisis. In sum, while overall social expenditures in liberal welfare systems were on average lower than those in almost all other welfare systems pre-crisis, post-crisis social spending in many policy areas was indistinguishable between liberal systems and other regimes. This seems to indicate the need of many national governments to reduce expenditures in response to severe economic shocks and long-term conditions of austerity.

**Nordic Welfare Systems**

The data indicates that in the pre-crisis period Nordic welfare systems were characteristically generous across a range of different social policy areas. Total public social spending increased by 7.38 percent of GDP on average during this timeframe. While continuing to be positively correlated with social spending, Nordic countries reduced these expenditures considerably in the aftermath of the economic crisis. In fact, overall social spending across Nordic states dropped by over half to 3.42 percent of GDP (See Table 10). This indicates a more modest social spending response that may reflect a need for these states to adjust welfare state policies to a post-crisis environment of low economic growth and the need for greater fiscal austerity. This finding provides surprising evidence for how Nordic welfare systems have responded to the economic crisis and highlights the pressure that these states face to reduce costly social expenditures. It is
important to note however, that this trend does not necessarily indicate a convergence toward a liberal welfare model, rather it indicates the need for social policy readjustment and more modest spending in a period of constrained fiscal resources.

Automatic stabilizers may provide an important explanation for the continued, yet noticeably more modest expansion of the Nordic welfare states. Large welfare systems, like those that exist throughout Northern Europe, include mechanisms for automatic counter-cyclical expansion of public spending on social policy in times of crisis (Dolls et al., 2010; Girouard and André, 2005). These measures provide a stabilizer effect for the economy and limit the social impact of the crisis. Basically, as the crisis begins to affect the domestic market, social expenditures rise as more and more individuals begin to rely on social protection measures, such as unemployment benefits (Girouard and André, 2005; Starke et al., 2012, 16). Since these benefits are universal, not means-tested, a larger number of individuals qualify for support. Additionally, policies such as short-time work benefits and early retirement, as well as, non-labor market policies such as health, old age and family policies provide counter-cyclical social support which can magnify the automatic stabilizer effect (Darby and Melitz, 2008).

The benefit of these automatic stabilizers is that they provide important protection against the negative social effects of the crisis which helps to stabilize economic growth rates and reduce long-term deficits (Starke et al., 2012, 19). However, the short-term increase in public expenditures in the aftermath of a crisis can create a large fiscal burden that may generate demand for welfare spending reductions in the long-term. As a result, in Nordic states, with large welfare systems, greater demand may be generated to contain costs (see Table 10). Overall, since the start of the crisis there has been continued welfare expansion in Nordic welfare states, but at more modest rate than in the pre-crisis period.
Continental Welfare Systems

Continental welfare systems\(^{13}\) were correlated with high levels of social spending in the pre-crisis period. During this period, overall social spending increases represented 7.92 percent of GDP, the highest of any welfare regime type. These welfare systems were also positively correlated with social spending across all social policy areas during this time (See Table 10). Continental welfare regimes responded to the crisis in a similar manner as Nordic states by continuing to provide positive social spending, albeit at reduced levels these expenditures. Total government social spending across these regimes fell by 0.91 to 7.01 of GDP on average post-crisis, yet this level of spending has remained higher than other welfare systems. This indicates an important difference between Nordic systems, which decreased social expenditures to a greater extent than Continental regimes, which implemented more modest reductions.

As in the case of Northern Europe, Continental states have large welfare systems with strong automatic stabilizer effects. It is unsurprising then that social spending increased in these states in the aftermath of the economic crisis. However, relative to Nordic states Continental welfare systems are smaller and thus may have faced less pressure to reduce social expenditures post-crisis (see Table 10). In addition to overall social spending trends, the data also indicates that unemployment spending increased in Continental states during the post-crisis period by 0.29 percent of GDP. This provides some further validation of the role that automatic stabilizers play in shaping the crisis management response of Continental regimes. Unemployment policies, including policies such as short-time work schemes, serve as important ‘safety valves’ in

\(^{13}\) Note that these systems exclude Southern and Eastern European welfare systems, which although they share many of the same institutional features represent distinct welfare system categories.
Continental European welfare system during times of crisis and would be expected to increase in the aftermath of economic turmoil.

However, it is important to note that increased unemployment spending does not necessarily address the issues related to dualization and social exclusion that exist within some of these regimes. Although, unemployment spending was positively correlated with these regimes post-crisis, these policies may continue to favor labor market insiders over anyone else. Short-time work policies, for example, provide income protection and lower the risks of being laid off for the core workforce, but do little to improve labor market access for labor market outsiders, such as the unemployed, youth, women, and atypical workers, who need greater job opportunities and improved labor market skills (Häusermann and Schwander, 2010, 5). In fact, the lack of social services aimed at promoting workforce skill development and increased employment can lead to increased dependency on unemployment and other passive benefits, which may result in the greater social exclusion of vulnerable groups (Palme, 2009, 16).

Post-crisis spending on ALMPs gives some indication of the continued prevalence of labor market divisions within these states. While Continental regimes were correlated with positive ALMP spending pre-crisis representing 0.40 percent of GDP, post-crisis these regimes were not statistically significant in affecting social spending in this area. This indicates that these regimes have not been responsive in promoting these types of social investment strategies post-crisis. The crisis may underscore some of the political divisions within Continental regimes with politically influential insiders pushing against social spending targeted at outsider groups. This confirms some of the expectation about the dualization existing within these regimes and highlights the effects that economic crisis have emphasizing these divisions. As economic conditions worsen and national budgets are tightened, political divisions may increase between insiders benefitting from
social protection measures and underrepresented outsiders who seek greater assistance. In sum, while Continental welfare systems continue to provide generous social spending in the post-crisis period, particularly in the area of unemployment policies, this welfare state response may not address the dualization which remains problematic within these systems.

**Southern European Welfare Systems**

Whereas Southern European welfare systems did not have a statistically significant effect on social spending in the pre-crisis period, in the post-crisis period these regimes are correlated with significant welfare retrenchment. On average these systems cutback overall social spending by 2.15 percent of GDP and were associated with reductions in unemployment, health, and family policies (See Table 10). Much of this retrenchment reflects the austerity measures implemented by states in order to reduce government debt and deficit levels. In many respects, these regimes face many of the same challenges as Continental European welfare regimes, but far less able to respond effectively to the social and economic challenges that have arisen post-crisis. Labor market dualization is far more pronounced in Southern European states as labor market access is highly protected for core workers. Due to the small size of the welfare system, countries such as Greece, Italy, Portugal, and Spain have few of the automatic stabilizers found in Continental and Nordic systems to provide counter-cyclical social protection (Dolls et al., 2010, 6). Since unemployment benefits are substantially less generous in these countries, little income stabilization exists for poor groups (Dolls et al., 2010, 16). Thus the shock of unemployment is far more pronounced in these states leading to worsening social conditions and economic growth forecasts. Since social spending does not automatically increase in these states, policies become more subject to political contestation. Additionally, spending needs to be introduced in specific legislation which means
there is a higher probability that these measures become subject to partisan struggles (Starke et al., 2012, 22). In sum, Southern European welfare systems have been some of the hardest hit by the economic crisis and have not been able to respond effectively with redistributive policies, opting instead to adopt pro-cyclical social spending cuts. Whereas in Northern and Continental Europe automatic social spending increases insulated these policies from the need for political debate, thereby lessening divisions, in Southern European welfare states social spending is discretionary and subject to greater political contestation. The result has been a retrenchment of the welfare spending in these states, higher unemployment levels, lower economic growth, and increasing polarization within domestic politics.

**Eastern European Welfare Systems**

Eastern European welfare regimes in the pre-crisis period were correlated with increased social welfare spending reflecting a process of “catching-up” with other more mature welfare states in Western Europe. During this time, average overall social spending increased by 4.12 percent of GDP on average representing considerable welfare expansion. This includes increased spending on family policies, which typically allow for greater female workforce participation, and higher levels of old age spending to address the needs of an aging population (See Table 10). At the same time, these regimes saw an average decrease in unemployment spending pre-crisis reflecting a liberalization of labor markets in these countries as they have transitioned to a capitalist economic structure. Labor market liberalization, while representing welfare state retrenchment, is still an integral part of the process towards the development of an efficient welfare model similar to those systems in other mature EU member states.
The data indicates that the crisis significantly affected the relationship between Eastern European welfare systems and social spending. In the wake of the crisis, the social spending expansion of the pre-crisis timeframe came to a halt. This cessation of social spending expansion in Eastern European welfare states can be tied to many of the same problems faced in Southern Europe. Similar to Southern European welfare states, social protection systems in Eastern Europe are small compared with those in Continental and Northern Europe and, as a result, have fewer automatic stabilizers (Dolls et al., 2010, 6). This reduces the automatic redistributive effect and makes social policy decisions subject to more partisan debates (IMF, 2009; Starke et al., 2012, 22). However, this event has not led the same social spending cutbacks as those implemented in Southern Europe. In part, this may be due to some of the increased labor market flexibility and economic structural reforms adopted in Eastern Europe. Even though unemployment spending continues to be negatively correlated with Eastern European welfare systems the magnitude of this effect has been reduced. In other words, while these states on average continue to cut back on unemployment policies they have done so at a lower rate since the crisis began. Overall, the data suggests that the crisis had a significant influence on Eastern European welfare institutions leading to an end of welfare state expansion that was prominent in the pre-crisis period.

**Overview Welfare Systems**

In sum, there was significant variation in the social spending responsiveness of different welfare systems to the 2008 economic shock. Whereas Continental and Nordic states responded to the crisis by reducing some expenditures, both welfare systems remained positively correlated with social spending increases. In contrast, although overall social spending in Southern European welfare states was comparable to expenditures in liberal regimes pre-crisis, they were associated
with pro-cyclical spending cuts across policy areas in the post-crisis period. Social spending in Eastern European welfare systems had an inverse relationship as that of Southern regimes. Whereas overall social spending increased in Eastern regimes pre-crisis, indicating an expansion of the welfare state, social expenditures post-crisis were undifferentiated from liberal systems post-crisis. This suggests a halt to welfare state growth in Eastern European although it does reflect the same social policy retrenchment seen across Southern European systems. These different outcomes reflect some of the major challenges facing European policymakers going forward. Establishing harmonized policy responses across the region to ensure economic growth and social stability may prove difficult. Policies which may be relevant for one welfare system may be problematic for others as each system appears to have been impacted by and responded to the crisis very differently. The crisis will, therefore, provide important lessons for EU member states in the future about how to respond to severe economic downturn. Chapters 4-6 will explore the effects of these welfare systems and political dynamics within states more closely.

Table 10. Welfare System Influences on Social Spending

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<td><strong>Social Spending as % GDP</strong></td>
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<td>continental</td>
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<tr>
<td>continental post-crisis</td>
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<td>nordic</td>
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<td>nordic post-crisis</td>
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<td>eastern</td>
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<td>eastern post-crisis</td>
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<tr>
<td>southern</td>
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<td>southern post-crisis</td>
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|                      |                        |                         |
| **Unemployment Spending as % GDP** |                        |                         |
| continental         |                        |                         |
| continental post-crisis |    0                   | 5                       |
| nordic              |                        |                         |
| nordic post-crisis   | 0                      | 5                       |
| eastern             |                        |                         |
| eastern post-crisis  | -5                     | 0                        |
| southern            |                        |                         |
| southern post-crisis | -10                    | 0                        |
Note that these graphs only show the effects of variables which were statistically significant in either or both the pre- or post-crisis periods.

Electoral System and Political Party Influences on Social Spending

Finally, the panel data analysis indicates that neither PR electoral systems nor the presence of a strong Christian Democratic party had a statistically significant effect on social spending levels pre-crisis. However, in the aftermath of the economic crisis the data seems to confirm that the hypothesized effects of both variables to be statistically significant. This is a major finding as it provides some indication as to when and under what conditions electoral systems and political composition of government influence social spending outcomes. Contrary to the expectations outlined in existing welfare state literature this finding suggests that these political variables have not always had a significant effect on social spending outcomes, rather these factors only became
significant in the aftermath of the global economic crisis. This suggests that the crisis generated conditions in which the effects of political variables became more pronounced and significant in defining national social spending levels.

**Electoral Systems**

In the pre-crisis period PR institutions were not statistically significant in influencing overall social spending levels. However, in the post-crisis period these electoral systems were positively correlated with overall social spending, with an average increase of 0.39 percent of GDP across states. In addition to the effects on overall social spending post-crisis, PR electoral systems were also positively correlated with increased social spending on unemployment and family policies. Whereas PR systems were correlated with retrenchment in Health and Old Age policies pre-crisis, social spending in these systems could not be differentiated from majoritarian institutions post-crisis. This indicates a halt to cut backs in these policy areas post-crisis. Similarly, while PR systems were associated with ALMP retrenchment pre-crisis, in the aftermath of the economic downturn the level of these cut backs were more modest (See Table 11). This indicates that even in social policy areas where PR systems were cutting expenditures pre-crisis they responded to worsening economic conditions by ending retrenchment in these areas.

In contrast, whereas mixed electoral systems were negatively correlated with overall social spending in the pre-crisis period, levels of social expenditures were on par with majoritarian systems post-crisis indicating a pause in social policy cutbacks in these systems. However, it is important to note that post-crisis mixed electoral systems were correlated with cutbacks in Health and Old Age spending. This may indicate the need to offset the rising costs of these policy areas in an atmosphere of economic austerity. Ultimately, the data indicates a significant shift between
the two timeframes, during which the effects that electoral systems had on social spending outcomes changed dramatically. These findings suggest that PR electoral systems are correlated with positive social spending as hypothesized by comparative welfare state literature, however, this effect is only significant in the post-crisis period providing compelling evidence of the influence that economic shocks have on political institution relevancy.

**Political Parties**

The economic crisis also profoundly displayed the effects that political party composition had on the social spending responsiveness of countries. While the presence of a strong CD party in government did not significantly affect social spending in the pre-crisis period, these political parties were negatively correlated with social spending outcomes post-crisis resulting in cutbacks of 0.43 percent of GDP. Similar to overall levels of social spending, although CD parties were not significant in affecting unemployment and family spending pre-crisis, these parties were negatively correlated with spending in both these policy areas post-crisis (See Table 11). The effects that strong CD presence has in both of these areas is unsurprising as these policies typically benefit labor market outsiders not as well represented within these political coalitions (Iversen and Soskice, 2010). What is unexpected, however, is the fact that political party differences appear to be relatively insignificant pre-crisis, but extremely important in shaping the social policy responses of states in the post-crisis environment. Even in policy areas such as Old Age spending, where CD party presence was correlated with social expenditure reductions, the magnitude of these cutbacks has increased remarkably post-crisis (See Table 11). Again this emphasizes the major impact that the economic crisis has had on the relationship between political variables and domestic social spending responsiveness. The implications of this analysis are profound suggesting that political
debates defined by electoral systems and the divisions between parties became far more significant under conditions of economic crisis.

Table 11. Electoral System and Political Party Influences on Social Spending

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<td><strong>Social Spending as % GDP</strong></td>
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<td><strong>Unemployment Spending as % GDP</strong></td>
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<td>pr post-crisis</td>
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<td>mixed post-crisis</td>
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* Note that these graphs only show the effects of variables which were statistically significant in either or both the pre- or post-crisis periods.

**Conclusion**

Overall, these findings highlight the significant effect that the global economic crisis has had in altering the relationship between political and institutional variables and social spending outcomes across states. While the welfare state literature has identified a number of political and institutional factors theorized as important in shaping government social policy patterns, the data clearly indicate that the crisis profoundly reshaped the influence that these variables have on social spending. In other words, the dynamics of social spending in the aftermath of the global economic crisis are fundamentally different than the period of relative economic stability before the downturn. Whereas political variables, including electoral system and political party control of government, were not statistically significant in influencing social spending during the pre-crisis period, post-crisis these factors became central to national crisis management responses. This finding provides useful insights as to when and under what conditions political variables shape domestic social spending patterns.

In addition to the key role that electoral institutions and political parties play in defining national crisis responses post-crisis, empirical analysis points to the importance of welfare systems
in mediating political conflict over social spending decisions. Although domestic social protection systems were significant in defining welfare policies prior to the crisis, the affect they had post-crisis differed considerably from previous spending patterns. This indicates a sharp contrast between the role that these systems have under normal economic conditions and during crisis conditions. In many respects, existing welfare arrangements helped to define the challenges that different states faced and the types of policy responses put forth by governments.

Finally, these findings suggest that social spending responses to the crisis were not only shaped by domestic political and institutional factors, but in the case of EU member states, were influenced by European level variables. Whereas EU and Eurozone membership was associated with similar social spending during the pre-crisis period, there was a notable divergence in respective levels of responsiveness post-crisis. In addition to the influence of EU and Eurozone membership, specific EU policies, such as the European Fiscal Compact and Europe 2020, had a significant effect on national social spending outcomes.

Ultimately, this evidence suggests that not only did the global economic crisis change the social and economic conditions across states, it fundamentally altered the effects that different political and institutional variables had on the domestic social spending levels. Although the data confirm some of the expectations laid out in comparative welfare literature, they also reveal many unexpected results about the impact of the crisis on the dynamics of social policymaking. The next chapter will explore the effects of EU institutions and policies on social spending in the post-crisis period and provide greater detail of how European level factors shaped the policies and decisions of member states.
Chapter 4: The European Union

At the supranational level, EU institutions and policies serve as important intervening variables which help to shape the domestic welfare response of member states. While states maintain governing authority over social policy areas, decision-making is embedded within a larger European institutional context. My findings indicate that not only are European variables significant in influencing the social spending of EU member states, but that under the conditions of severe economic downturn and social dislocation resulting from the global economic crisis the political dynamics that exist between EU institutions and member state governments have been fundamentally different than during previous times of relative economic stability. In the decades leading up to the economic crisis, EU institutions were instrumental in promoting social policy liberalization, efforts which became widespread across different welfare states. The neoliberal policy agenda became prevalent across party lines, with even left leaning parties, in countries such as the UK, Denmark, and Sweden, focusing more attention on social investment and workforce activation strategies, rather than the passive welfare benefits of the past (Häusermann and Palier, 2008). As a result, political conflict over social spending was relatively muted during this time, as indicated by the lack of statistical significance that electoral systems and political parties had on social spending (see Table 11 Chapter 3).

However, the crisis not only generated increased demand for social support mechanisms, but also raised serious questions at the European level about the neoliberal policy agenda. In the immediate aftermath of the economic crisis EU institutions advocated for strong counter-cyclical responses to limit the social and economic consequences of the crisis, reversing previously held recommendations of government spending reductions (European Commission, 2008; European Commission, 2009b). In effect, this opened up space politically for greater debate and contestation.
over social spending. By 2010, the EU had once again started to reintroduce liberal policy recommendations, primarily in the form of austerity measures, such as fiscal limits and budgetary constraints. As such, despite EU membership no longer being correlated with social spending reductions, specific European-wide measures, most notably the 2012 Fiscal Compact, once again put pressure on states to lower public spending and reduce welfare state expenditures. However, whereas liberal policy recommendations were fairly widely accepted by member states in the past, the post-crisis environment has given rise to sharp political debates over government spending and social welfare provisions.

This chapter examines the evolution of EU institutional capacity over social and economic issues and its effects on the social policy spending of member states. This will include an examination of the institutional development of “Social Europe” and the economic spillover effects on social policy areas that have resulted from increased economic harmonization at the European level. This historical overview will help to establish the growing significance that EU variables have on the social policy spending patterns of member states. Finally, it explores the prevailing social and economic policy approaches promoted by the EU during the pre- and post-crisis, highlighting the disrupting effect that the crisis has had on EU social and economic policymaking and producing increased politicization over social spending.

The EU and the Welfare State Pre-crisis

*European Economic Integration and Liberalization (1990s)*

While European welfare states have historically been associated with high levels of social spending, the 1990s marked notable welfare spending reductions across many states as national governments began to respond to the challenges of labor market transitions, the shift away from
an industrial-based economy, and demographic changes. In many respects, this trend was in stark contrast to earlier post-war European welfare state development, which was characterized by the dramatic growth and expansion of social welfare programs. The linkages that exist between domestic economic practices and welfare state policies depend greatly on social and economic context (Häusermann and Palier, 2008, 561). During the 1990s, this context had changed considerably due to increased globalization, Europeanization, and new prevailing economic recommendations. A focus on the importance of international finance and competition began to challenge the scope and capacity of national welfare states (Begg, Draxler, and Mortensen, 2008; Scharpf and Schmidt, 2000). Neoliberal policies promoted by international organizations such as the IMF and World Bank became ascendant as more and more policymakers and government leaders began to subscribe to “Washington Consensus” notions on how best to promote investment, economic growth, and prosperity. These liberal market policies emphasized price stabilization, fiscal discipline, privatization, deregulation, the liberalization of trade and capital markets, and lowered state spending (Rodrik, 2011).

Inspired by neoliberal economic considerations, the OECD began to investigate the labor market performance and practices of its members in the early 1990s. Its 1994 OECD Jobs Study was critical of the high levels of unemployment present across European labor markets (Brandt, Burniaux, and Duval, 2005; OECD, 1994, 1997, 2006). Long-term unemployment rates were around 10 percent in three of the region’s largest economies, Germany, France, and Italy, rates in nearly twice as high as that in the US and other liberal market economies (Hemerijck, 2013, 129). The report concluded that generous European welfare states were, in part, to blame for this problem as high levels of job protection, high minimum wages, and generous unemployment policies led to the higher labor market costs contributing to unemployment (OECD, 1994, 1997). The
implications of these reports was that well-funded and comprehensive European welfare systems undermined the efficiency of the market, generating high levels of unemployment and low levels of growth.

Whereas these OECD reports were highly influential in shaping the discussion on social and economic policy reform in Europe, EU institutions were critical in influencing the domestic policies of member states. European integration and economic harmonization during this time reflected liberal market practices as the European Commission and other EU institutions worked to promote cross-border investment and trade with the aim of strengthening the European Economic Governance structure (Leschke and Jepsen, 2012). Responding to increased concerns of ‘Eurosclerosis’ raised by neoliberal advocates, European economic integration began to expand greatly with the introduction of the Single European Market Act in the late 1980s (Hemerijck, 2013, 131; Scharpf, 2002, 647). European authority over economic matters in the region continued to grow throughout the decade and became even more significant with the signing of the Maastricht Treaty in 1992 and formation of the Economic Monetary Union (EMU) in 1999 (Hemerijck, 2013; Scharpf, 2002). Maastricht convergence criteria for joining the EMU – requiring states to maintain government deficits below 3% of GDP, keep debt levels below 60% of GDP, sustain low inflation, and ensure stable interest rates – were founded on neoliberal policy recommendations (Hemerijck, 2013, 131). The introduction of the Single Market and EMU during this time, therefore, represented a clear shift toward neoliberal market driven policies across Europe and reflected the expansion of EU authority to intervene in the domestic markets of member states. In many respects, this economic integration greatly reduced the capacity of member states to determine their own economic policies and limited the ability for national governments to define their social goals (Scharpf, 2002, 648).
The new European economic institutional arrangements that emerged in the 1990s altered the relationship between domestic social and economic management and international trade and finance. This process of European integration created asymmetries between economic policies, which were gradually Europeanized, and social policies, which remained at the national level (Scharpf, 2002). Such a bifurcation allowed liberal economic discourse to frame the European agenda almost exclusively in terms of market efficiency, integration, and liberalization (Scharpf, 2002), leading to social policy and labor market reforms across states focusing on competition, labor market liberalization, and reduced government expenditures. With the aim of removing obstacles to workforce participation and improving labor market efficiency, these policies were accompanied by benefit cuts, tightening of eligibility requirements, and overall welfare state retrenchment (Hemerijck, 2013, 132). Overall, new market driven social pacts and labor market reforms accompanied, if not led to, reductions in social benefits across many EU member states (Hemerijck, 2013), as is evidenced by the negative correlation between EU membership and social spending during the pre-crisis period (see Table 12).

Although neoliberal policies adopted by EU institutions helped to improve monetary stability, budgetary restraint, labor market flexibility, and workforce activation, welfare retrenchment throughout the region accompanied, if not outright producing, greater inequality and higher levels of poverty (Hemerijck, 2013). This trend was true even for the more egalitarian advanced welfare states in Scandinavia and Continental Europe (Kenworthy, 2008; Hemerijck, 2013). While these policy trends did not constitute a regional convergence toward a liberal welfare model, there was significant reduction of public expenditures and a focus on structural reform policies across EU member states (Thelen, 2012). By the end of the decade, growing disenchantment with neoliberal welfare state retrenchment, deregulation, and rising inequality led many states, and citizens who
had come to rely on social protection against the effects of the market, to advocate for a greater European level focus on social concerns (Hemerijck, 2013; Scharpf, 2002). Critics argued that EU institutions should play a greater role in protecting the ‘European social model’ and correcting the imbalances that had developed at the European level between economic policies and social protection policies (Scharpf, 2002, 649).

**Social Investment Strategies (2000s)**

Reflecting the growing importance of social policy concerns, in 1997 the European Commission, in cooperation with the Dutch Ministry of Social Affairs and Employment, staged a high-level conference on ‘Social Policy as Productive Factor’ (Hemerijck, 2013). The goal of the conference was to promote the view that social investment strategies have the potential not only to increase social protection, but can also promote increases in productivity and economic output (Hemerijck, 2013). Whereas prevailing neoliberal arguments claimed that there was a trade-off between social protection and economic efficiency, social investment advocates argued that social and economic policies can be mutually reinforcing. This notion, that social policy can potentially foster increased productivity and economic growth, became a central tenant of the EU social investment approach during the 2000s (Hemerijck, 2013). The rise of social democratic parties during this time in countries such as the UK, Germany, Denmark, and the Netherlands contributed to the increased prominence of the social investment approach being promoted at the European level. These parties advocated for a transformation of European welfare states from passive benefit providers toward active labor market promoters (Hemerijck, 2013). Interestingly, the social investment policy approaches adopted by even left-wing social democratic parties were predicated upon liberal market based strategies, including social investment strategies, ALMPs, and
flexicurity policies. In many respects these social investment strategies represented and attempt to reconcile the desire for strong social protection with widely accepted liberal policies that focused on market efficiency and competition.

In 2000, the European Council, with support from the European Commission, raised the social and economic policy ambitions of the EU by adopting an integrated political agenda that introduced new social objective goals within the existing economic growth and employment paradigm (Hemerijck, 2013). This ‘Lisbon Strategy’ was influenced by social investment perspectives and sought to emphasize the positive complementarities between economic efficiency and an active and dynamic welfare state (European Council, 2000). In addition to the goals of increasing employment and protecting vulnerable populations throughout Europe, the Lisbon Strategy broadened the notion of social policy to include workforce skill development, training and education, and greater labor market access to outsider groups, such as women and youth workers (Hemerijck, 2013, 132).

Although social policy concerns were advanced at the European level, attempts to harmonize social outcomes across member states were politically constrained by the diversity of domestic welfare regimes. Social protection systems across member states varied considerably not only in their level of generosity and ability to provide social transfers and services, but in their normative outlooks and institutional structures (Scharpf, 2002, 666). To address the considerable differences between EU welfare states, the Lisbon Strategy introduced the Open Method of Co-ordination (OMC), a set of non-binding instruments, including guidelines, indicators, and the establishment of national action plans, intended to spread best practices (Van Vliet, 2010, 271). The OMC was designed to allow the EU to promote shared objectives, identify common indicators of success,
and provide comparative evaluations of national policy performance, while granting national
governments the flexibility to implement their own social policies (Scharpf, 2002, 666).

**Lisbon Strategy Relaunch (2005)**

While the Lisbon Strategy represented an unprecedented attempt to incorporate social issues
into the EU agenda, there remained significant problems with its implementation and
achievements. By early 2005, the European Commission’s five year mid-term review concluded
that the Strategy had failed to make progress toward its key objective of turning the EU into ‘the
most competitive and dynamic knowledge-based economy in the world’ (Dieckhoff and Gallie,
2007; Zeitlin, 2008). An evaluation conducted a year earlier, chaired by former Dutch Prime
Minister Wim Kok, highlighted the ineffectiveness of the OMC citing in particular the weakness
of the benchmarking and peer review processes (Kok, 2004; Zeitlin, 2008). Rather than
abandoning the Strategy, in 2005 the Commission decided on a major relaunch of the Lisbon
framework, with the main focus on the principal tasks of “delivering stronger, lasting growth and
creating more and better jobs” (European Commission, 2005, 7).

However, this sharper focus on growth and jobs raised concerns that the “new” Lisbon Strategy
framework diminished the importance of social objectives. In response, non-governmental
organizations in Europe, working with support from key member states and the European
Parliament, launched a successful EU-level campaign to formally reinstate social objectives in the
revised Lisbon Strategy (Zeitlin, 2008). This decision was reaffirmed by the European Council,
which affirmed that economic, employment, and social policy were intended to mutually reinforce
each other (Dieckhoff and Gallie, 2007).
While social objectives were preserved in the revised Lisbon Strategy, there continued to be significant asymmetries between economic and social policies at the EU level. To begin with, specific institutional mechanisms to ensure positive feedback between social and economic goals were not clearly established within the revised framework (Zeitlin, 2008). This limited the effectiveness of the Strategy and resulted in wide variations in social outcomes among member states. Social goals were also notably absent from a number of important Lisbon Strategy revisions, including the new integrated guidelines for assessing member state progress (Dieckhoff and Gallie, 2007; Zeitlin, 2008). For example, in 2006, the European Commission released a paper outlining how the new Lisbon Strategy should be implemented by members which failed to make reference to the EU’s social objectives in the criteria that states would need to identify in their National Progress Reports (Zeitlin, 2008). As a result, during the first round of National Reform Program Implementation Reports only ten member states referred explicitly to social objectives among their national priorities (Zeitlin, 2008). Additionally, few of the dedicated European structural funds intended for Lisbon Strategy goals appear to have been dedicated toward social objectives, being used instead toward job creation and other economic goals (Zeitlin, 2008). By failing to incorporate social goals in the new integrated Lisbon guidelines and policy changes, EU institutions effectively reinforced imbalances between economic and social issues at the European level (Dieckhoff and Gallie, 2007; Zeitlin, 2008).

In essence, the 2005 relaunch made clear that the social agenda was subordinate to economic goals (Dieckhoff and Gallie, 2007; Zeitlin, 2008). In fact, the prevailing philosophy of the relaunch seemed to be that social objectives would be advanced by promoting economic success, so priority should be on economic growth and job creation (Dieckhoff and Gallie, 2007; Zeitlin, 2008). Although proponents of a stronger ‘Social Europe’ had achieved a degree of success
with preservation of social goals in the 2005 Lisbon relaunch, several member states expressed dissatisfaction with the predominantly economic focus of the reforms. The Employment, Social Policy, Health and Consumer Affairs Council (EPSCO), an EU body composed of ministers of employment, social affairs, health and consumer policy from all member states, argued that a narrowly economic efficiency focus was insufficient to address the deep-seated causes of poverty and social exclusion. EPSCO representatives argued that priority must be given to concerns that would not be addressed by addressing unemployment alone, such as child poverty reduction, family support, gender equality, improved social services, homelessness, and the integration of ethnic minorities and immigrants (Dieckhoff and Gallie, 2007). However, the revised Lisbon Strategy remained focused on short-term economic priorities and led to few policy initiatives to address the socially disadvantaged populations beyond increasing employment and human capital through active labor market policies. Social policy reforms in areas such as unemployment benefits continued to represent a liberal policy approach through the individualization, decentralization, and privatization of employment services (Leschke and Jepsen, 2012, 295). These continued asymmetries between economic and social goals were largely as a result of prevailing neoliberal conceptions among elites in the European policymaking process.

Overall, the decades immediately preceding the global economic crisis saw the widespread liberalization of social welfare policies across Europe. During the 1990s, neoliberal policies focused on reducing welfare expenditures as a means to stimulate economic growth and address the high levels of unemployment gained considerable support throughout the region. By the early 2000s, concerns over growing income equality and social exclusion led to more consideration of the mutually reinforcing role that social and economic policies can have on one another. Even so, economic concerns remained the leading priority, with continued EU pressure on member states
to liberalize labor markets and reduce social welfare spending. Such dictates met with relatively little political resistance as many political parties on the left and right embraced these liberal reforms (Hendrik et al., 2004).

In a general sense the social policy reform efforts that took place across Europe during these two decades appear to reflect a liberalization of the welfare state as a wide range of countries adopted greater labor market flexibility and market-based strategies to promote workforce activation, rather than providing passive social support. EU institutions promoted a liberal approach toward social policy reform in Europe during this time and in doing so established an authoritative path for member states to follow. This contributed to an atmosphere in which liberal policies were widely accepted across political parties within states and adopted with little domestic conflict (Hendrik et al., 2004). Danish flexicurity, ‘third way’ policies in the UK, and activation policies in Sweden all seem to reflect a common shift from non-market to liberal welfare strategies. Such employment-friendly welfare reforms seemed to be a preferred strategy of states as they sought to focus on employment promotion, rather than the provision of passive welfare benefits, a significant recalibration insofar that these reforms were widely adopted across different welfare systems. Welfare state liberalization became essentially depoliticized.
Table 12. EU Level Influence on Overall Social Spending

* Note that this graph only shows the effects of EU level variables which were statistically significant in either the pre- or post-crisis periods.

The EU and the Welfare State Post-crisis

Crisis Management Stimulus Measures (2008-2010)

The global economic crisis marks a significant turning point in European welfare state spending as governments began to implement counter-cyclical stimulus measures to offset the negative effects of the crisis. Not only did the spending patterns of EU members change, so too did the relationship between EU institutions and the social welfare states. In the post-crisis period, the effect of EU membership on social spending outcomes no longer has a statistically significant effect (see Table 12). This finding is important as it indicates that EU membership is no longer correlated with welfare state reductions as social spending became comparable to that of other OECD states post-crisis. During this timeframe, we also see that Eurozone membership has become correlated with social spending increases (see Table 12). In other words, rather than creating top down pressure toward liberal reforms and welfare state reductions, EU institutions in
the immediate aftermath of the crisis advocated for states to undertake counter-cyclical social spending increases (European Commission, 2008). As the crisis has worn on, however, specific EU policies, notably the 2012 Fiscal Compact, once again began to put pressure on member states to reduce social spending. In order to understand these changes, it is important to examine EU social and economic crisis management policies and recommendations in the wake of the financial downturn and growing sovereign debt problem.

Due to a greater need for social support mechanisms, such as unemployment policies and family benefits, a higher percentage of state revenue has been absorbed by the welfare state in the aftermath of the economic crisis. According to Eurostat, the statistical office of the EU, social spending on average across member states increased from 26.1% of GDP in 2007 to 29.6% in 2009 and has stabilized since (Eurostat, 2011). The trend is similar for Eurozone members, where social spending increased markedly from 26.8% in 2007 to 30.4% in 2009 and stabilizing at this level thereafter (Eurostat, 2011). Despite the recent decades of liberalization and welfare state reductions, social spending in EU member states increased significantly in the aftermath of the economic crisis, and has been more generous than the OECD average. Across the OECD, public social spending as a percentage of GDP rose from around 19% of GDP in 2007 to 22% by 2009, remaining around this level since (OECD, 2012).

EU institutions played an important role in influencing the social spending policies of member states during the post-crisis period. By early 2008, it became clear that EU institutions and member states needed to undertake strong and rapid policy actions to minimize the negative consequences of the unfolding crisis. Recognizing the need for a coherent regional response, the European Commission in 2008 introduced the *European Economic Recovery Plan* which offered a comprehensive framework for coordinated action at both the national and EU levels (European
The Plan included both economic and social dimensions that sought to restore market confidence, stimulate investment in EU economies, create jobs, and provide support and training to unemployed workers (European Commission, 2008). In many respects, the Recovery Plan provided an authoritative framework for member states to coordinate national stimulus packages to optimize their impact and avoid negative spill-over effects between countries (European Commission, 2009b). In addition, the EU dedicated €200 billion in structural funds, representing 1.5% of overall EU GDP, toward regional recovery efforts (European Commission, 2009b). The Recovery Plan therefore provided EU resources and recommendations in support of national stimulus efforts to revitalize domestic economies, address unemployment, and protect socially vulnerable groups.

**Structural Reforms and Austerity Measures (2010-Present)**

At the same time that EU institutions were encouraging member states to adopt crisis management stimulus measures to protect citizens and domestic economies, considerable efforts were undertaken to reinforce and strengthen European economic governance in an attempt to restore market confidence, create buffers against further financial market contagion, and limit the potential of future crises. Efforts, such as the expanded mandate of the European Central Bank to act as a lender of last resort and the establishment of European Supervisory Authorities to regulate the European financial system, constituted significant expansion of EU authority over economic activities in the region. As the crisis wore on, additional measures were adopted to create closer fiscal integration across the EU, particularly among Eurozone member states. In 2011, with the goal of reforming the Stability and Growth Pact (SGP) and introducing a new set of economic and fiscal surveillance processes, the EU adopted a series of five regulations and one directive intended
to establish concrete and decisive steps towards ensuring fiscal discipline in the region (European Commission, 2012a). This policy ‘six-pack’ committed all 28 EU member states to strict limits on government deficit and debt levels in accordance with the SGP requirements and introduced new compliance rules to enforce greater budgetary discipline among members (European Commission, 2012a). Member states now are required to provide financial and budgetary compliance reports to the European Commission and the Council of Ministers for scrutiny (European Commission, 2012a). An additional set of measures, the ‘two-pack,’ was adopted in 2011 for all Eurozone members requiring increased coordination and surveillance of national budgetary processes (European Commission, 2012a).

A 2012 report put out by President of the European Council, Herman Van Rompuy, outlines the move to develop a stronger Eurozone architecture which would include integrated financial, budgetary, and economic frameworks (European Council, 2012a). Since the national policies do not operate in isolation and have the potential to affect all Eurozone member states, the report argues in favor of establishing common rules to coordinate state behavior (European Council, 2012). A major legislative piece of this initiative was the adoption of the 2012 Fiscal Compact which created binding rules for all Eurozone member states to lower the limit of their structural deficits, not to exceed 0.5 per cent of GDP, and meet strict budgetary requirements (European Commission, 2012a). The Fiscal Compact also requires governments to pass balanced budget rules, which must be incorporated into national legal systems, ideally at constitutional level (European Commission, 2012b). As a result of these newly introduced pieces of legislation, EU institutions gained increased control and oversight of member state economic activities representing a loss of sovereignty for national governments.
Overall, these policies constituted a significant shift away from early stimulus spending efforts to a crisis management strategy of fiscal austerity and the reintroduction of a liberal policy approach to addressing economic growth concerns. In addition, to general austerity rules put in place across the EU several states faced with severe debt crises required bailout funds from the EU, ECB, and IMF conditional on the adoption of strict domestic austerity measures and economic structural reforms. By 2010, it was clear that a number of countries were struggling with growing sovereign debt concerns and mounting public deficits, some of which stemmed from emergency stimulus spending (See Figure 1). In the context of the continuing public debt crisis in Europe, Greece, Ireland, Portugal, Spain, and Cyprus each received emergency assistance in the form of EU and IMF bailouts. As part of these bailout agreements, national governments in each state adopted extraordinary fiscal adjustment packages to limit government spending and debt. Between 2009 and 2014 Greece cut its deficits from 13.6% to 3% of GDP; Ireland agreed to cut its deficit from 12.2% of GDP to 3% of GDP by 2015; by 2013, Portugal had cut its deficit from 9.1% to 3% of GDP (European Commission 2014). Spain, Italy, France, and Iceland made similar reductions to their budget deficits during this timeframe. Adjustment packages and fiscal reduction policies were also approved by the EU and IMF for Hungary, Latvia, and Romania (European Commission, 2014).
EU imposed austerity measures aim to improve fiscal discipline, particularly in Eurozone countries, and establish greater economic stability throughout the region. However, these policies also have a profound effect on the development of European social welfare. In fact, rather than creating a more unified Europe politically, socially, and economically, contentious crisis management policies may lead to wider divergence between member state policy positions calling into question the very meaning and viability of the European social model (Leschke and Jepsen, 2012). These imposed austerity measures, which constitute a clear return to neoliberal tendencies, highlight the conflict that persists at the EU level between economic and social concerns. In the aftermath of the economic crisis, this has led to increased politicization and intense conflict over the direction of European social and economic policy and the role of the welfare state. This politicization has manifested itself domestically between political parties within states, for example the rise of far-right and far-left parties in countries like Spain and Greece. This contestation has also occurred at the EU level as conflict over the effectiveness of austerity measures and the legitimacy of the neoliberal policy agenda has grown considerably.
EU austerity measures promoted by advocates such as Germany, the European Commission, and the IMF as an effective approach to end government debt concerns in the Eurozone and restore market confidence to sovereign bond markets, have subsequently come under severe attack. According to critics, rather than having a net benefit rigid austerity measures stifle economic growth and worsen social and economic problems across states. Continued austerity is cited as the main cause for the slow European economic recovery, high unemployment, and low consumer demand (ECFR, 2012, European Parliament, 2013). Opponents of austerity argue that significant cuts to public investment in education, research and development, and social services will have long term negative effects on economic growth.

Controversy has also arisen over the uneven manner in which member states have been negatively affected by austerity measures. According to calculations by the European Council on Foreign Relations, fiscal deficit reductions for the Eurozone area amounted to around 1.5% of GDP in 2012 and another 1% of GDP in 2013 (ECFR, 2012). Yet such reductions have been extremely uneven across states. For example, while Spain introduced large budget cuts worth nearly 3% of GDP in a single year, other states, including Germany, have required only negligible cuts (ECFR, 2012). The result is a significant reduction in government provided social benefits in some states, while others are able to maintain more comprehensive protection measures for their citizens.

**Politicization of Post-Crisis Social and Economic Policies**

In sum, the crisis has led to a fundamental debate in Europe over whether austerity or expansionary policies will produce desired economic and social outcomes. Fierce proponents of austerity, such as German Finance Minister Wolfgang Schäuble and British Chancellor of the
Exchequer George Osborne, view fiscal discipline as crucial to reducing excessive debt and restoring market confidence throughout the EU. In fact, support for the 2012 Fiscal Compact and the implementation austerity policies throughout the region have been a cornerstone of Angela Merkel’s Christian Democratic governments’ response to the euro crisis. These policies have received widespread public and media support in Germany (Economist, 2012). On the other hand, we see the rise in prominence of populist left-leaning parties in countries such as France, Greece, and Spain, which have run on platforms that oppose austerity measures and seek to renegotiate EU social and economic policy positions.

The economic crisis, and subsequent debates over how best to effectively respond to this event, has generated important shifts in the political landscape across Europe. In many respects, conservative parties were the clear electoral winners across Europe in the wake of the financial and sovereign debt crises. By 2012, 19 of the 27 heads of government in EU countries were from center-right parties and critically this included 11 of the 17 Eurozone members states (Deutsche Bank, 2012). Political upheaval has allowed Germany and other center-right governments, including in the UK, Netherlands, and Finland, to establish a conservative coalition with the ECB and European Commission to prioritize fiscal discipline and austerity measures over addressing deeper structural imbalances within the EU (EUCE, 2013; Regan, 2012). In many respects, this conservative coalition has helped to frame and legitimize long-term pro-austerity EU recovery strategies. However, whereas conservative parties advocating for fiscal discipline have dominated the EU crisis management responses so far, in recent years, we have seen a considerable counter response by left leaning parties in Europe who have begun to question the orthodoxy of neoliberal austerity measures and social spending reductions. For example, in 2012 the Socialist Party returned to power in France, after 17 years, with President François Hollande running on a platform
emphasizing growth over austerity. The French Socialist victory reflected a growing sentiment in some member states that the best way out of the crisis is to grant more flexibility in austerity requirements. A relaxation of fiscal discipline, it is argued, would allow national governments to undertake short-term stimulus measures to increase growth and address social concerns, such as unemployment and inequality. Once the economy returns to growth and stability, fiscal reforms can then be implemented.

In contrast, the German government has remained insistent on the need for EU countries in crisis to undertake immediate and far-reaching structural reforms coupled with sharp spending reductions (Spiegel, 2014). Critics of German backed austerity, argue that it is not international markets that are preventing countries like France and Italy from borrowing sensibly to fund fiscal stimulus efforts, but rather officials in Berlin and Brussels that are limiting the economic and social policy options of member states (Foreign Policy, 2015). This political conflict has taken on a wider European significance with member states and international institutions falling into opposing camps. France has sought allies including Italy and more recently the OECD and IMF in its pro-growth agenda (Telegraph, 2012). At the same time, in recent negotiations over the EU budget Germany has worked with the UK and some conservative-led Nordic states to limit spending proposals proposed by France and Southern European member states (Spiegel, 2014).

Further fuel was given to this debate in 2015 when Greece’s new coalition government, led by the far-left Syriza party, came into power on a wave of widespread public discontent over the austerity measures associated with the country’s bailout agreements. Since the adoption of these measures, the Greek economy has sunk further into recession, unemployment has soared and social benefits have been significantly cut leaving many vulnerable populations at risk (Independent, 2015a). Prime Minister Alexis Tsipras, the Syriza leader, has vowed to renegotiate
the his country’s economic bailout terms, but has faced significant resistance from other EU member states, primarily Germany, Finland, and the Netherlands, which have expressed reluctance to grant further debt write-offs to Greece (BBC, 2015a). In fact, in the most recent round of discussions over a bailout extension Greece has come into conflict with other indebted states, including Spain and Portugal, over terms of the negotiations, signaling intense inter-governmental conflict over debt crisis management responses (BBC, 2015b). The position of the newly elected Greek government has also placed the country on course for greater political conflict with the so called "troika," of the EU, ECB, and IMF responsible for providing the bailout funds and setting the conditions for Greek reforms. In statements to the press, Prime Minister Tsipras has said that his government would no longer work with the troika or accept new loans from the EU and IMF raising questions on how the state would pay off its existing debt burdens (BBC, 2015b).

The drama in Greece has also has led to greater concerns on behalf of European officials and governments that the actions of Syriza may embolden anti-austerity populist movements in other Eurozone countries, such as Italy, France, and Spain triggering further destabilization European markets and raising sovereign debt crisis concerns in the region. For example, inspired by the recent success of Syriza in Greece, the radical left Podemos party in Spain has made significant gains in public opinion polls. If it comes into political power, the party has vowed to renegotiate the terms of the country’s bailouts and secure write offs of Spanish debt (BBC, 2015c). Running on a populist anti-austerity platform Podemos has organized mass rallies of tens of thousands of citizens in central Madrid and is in a strong position to influence the national government. The populist anti-EU Five Star Movement in Italy has also run on a similar anti-austerity platform arguing in favor of the need to renegotiate Italian national debt (Wall Street Journal, 2015).
Overall, social and economic policy decisions have become highly politicized in the post-crisis period corresponding with a weakening of support for mainstream center-left and center-right parties that dominated Western European politics for decades. There has also been a considerable rise of parties on the far left and far right of the European political spectrum. In many respects, the conditions of austerity imposed on states in the aftermath of the economic crisis resulted in worsening social conditions within many states, in turn strengthening these more radical political parties. In addition to the success of far-left parties, such as Syriza and Podemos, recent years have also seen a notable growth of far-right extremist parties, including France’s Eurosceptic, anti-austerity, and anti-immigrant National Front party, which has received growing electoral support in recent years. In fact, the far right movement has been on the rise throughout Europe gaining a significant percentage of national parliamentary seats in Austria, Sweden, Hungary, the Netherlands, and Lithuania (Mirror 2015). Greece may be the most extreme example of this heightened polarization, with the rise of Syriza on the far-left and the anti-EU, anti-immigrant, and overtly fascist Golden Dawn party on the far right (ECFR, 2012).

This shift in the European political landscape has had important impacts on EU institutions. The 2014 European Parliamentary elections saw a significant challenge to the status quo as Eurosceptic parties on both the far-left and far-right made significant gains at the expense of traditional centrist parties. The anti-EU UK Independence Party (UKIP) won the European elections with 27.5% of the vote, receiving more support than either the center-right Conservative or the center-left Labor mainstream political parties (BBC, 2014a). The French far-right National Front party finished first in the 2014 election receiving nearly 25% of the vote and almost one third of France’s seats in the legislative body (France-Politique, 2014). Following its surge in domestic support, Spain’s Podemos party achieved success in EU elections where the party garnered nearly
8% of the vote and earned five seats in the European Parliament, displacing several traditional parties (BBC, 2014b). Not only did these electoral results come as a shock to the European establishment, they represented the first time that anti-EU parties have gained seats in the European Parliament (Reuters, 2014a).

At the heart of this political sea change is a significant questioning of the prevailing neoliberal orthodoxy and fierce political arguments over the effectiveness of austerity measures amidst a worsening in the social and economic conditions faced by many citizens. Political contention has extended to economic and social policies. Even international organizations like the EU and IMF have shifted their positions over time, with both acknowledging a failure to account for the negative economic and social consequences of harsh fiscal discipline on struggling member states (Bloomberg, 2013a; IMF, 2013; Washington Post, 2013).

In a 2012 Working Paper, the IMF indicated that reducing government expenditures too rapidly in economies with shrinking GDPs can create an even deeper recession and damage long-term growth prospects, without generating the desired fiscal savings (IMF, 2012a). A 2014 IMF report identifies the negative effect that growing social inequality has on health, education, investment, political stability, and economic growth (IMF, 2014). A similar 2014 OECD report identifies a correlation between rising income inequality and low levels of economic growth (OECD, 2014b). A 2015 OECD report on economic reforms urges government leaders to pursue economic growth policies that incorporate mechanisms for greater redistribution so as to help reduce rising inequality. Recommendations include investment in workforce training for labor market outsiders and increased social benefits (OECD, 2015a). This marks a significant about face from the OECD labor market reports of the 1990s, which blamed social institutions and redistributive mechanism for slowing economic growth.
EU institutions also continue to play an important role in this political conflict over regional social and economic responses to the crisis. On the one hand, the EU serves as the originator and enforcer of much of the region’s austerity policies, yet on several occasions these institutions have broken with fiscal policy conservative hardliners. For example, in 2012, then European Commission President José Manuel Barroso made quite a stir when he announced that, while he believed austerity policies were, “fundamentally right” that this approach had "reached its limits" (Spiegel, 2013a). Citing a lack of “political and social support" for austerity he suggested that in the short-term fiscal constraints should be relaxed and "a stronger emphasis on growth" would be needed (Spiegel, 2013a). Unsurprisingly, this statement solicited immediate backlash from German officials, such as Foreign Minister Guido Westerwelle who warned that "growth cannot be purchased with new debts," and from Herbert Reul, leader of the German conservatives in the European Parliament, who stated that, "the Commission president is putting the euro rescue in question" (Spiegel, 2013a). In addition to initiating further political divisions over austerity, the Commissioner’s statement signified several important aspects of the EU policy position. First, it identified continued support for austerity as a necessary long-term policy approach. Second, it identified the immediate need for relaxing Europe's austerity requirements and focusing more on public investment and growth strategies in the short-term. This represented an important shift from the strict austerity stance that the EU had taken previously. Third, there was an important recognition of the ways in which changing political dynamics in Europe constrain and shape viable EU social and economic policies.

Jean-Claude Juncker, current head of the European Commission, has taken a similar position as his predecessor. While acknowledging the importance of budgetary discipline, Mr. Juncker has argued that austerity on its own will not bring about the economic growth or job creation necessary
for a full European recovery (RTE, 2014). This softening of the EU Commission position on austerity has increased conflict between Brussels and leaders in Berlin and London. For instance, the Conservative UK government, under the leadership of David Cameron, actively sought to prevent Juncker’s ascension to the head of the European Commission based on concerns he would limit economic reforms they thought essential (Guardian, 2014a). The ECB’s decision to begin a program of Eurozone government bond purchasing in 2015 also represents a clear break with many German and UK policymakers who hold a deeply entrenched belief that central banks shouldn’t undertake quantitative easing measures to buy public debt (Wall Street Journal, 2015).

However, despite some softening in their positions, both the EU and IMF continue to be dedicated to austerity as a long-term solution to Europe’s economic woes. The move by the European Commission to grant national governments additional time to reduce their budget deficits stems largely from political reality and the fact that many of these targets are likely unattainable (Reuters, 2013). Although the IMF has identified the potential burden that harsh austerity measures can have on economic growth, ahead of recent negotiations between the EU and Greece over its bailout conditions, IMF Managing Director Christine Lagarde stated that, “there are internal euro zone rules to be respected” and that Greece will not receive special treatment (Reuters, 2013; Reuters, 2015a). Lagarde also indicated that Greece still needed to carry out key reforms and must continue with agreed upon austerity measures to reduce its national budget deficit (Reuters, 2015a). Politically contentious discussions between Greece and the EU at a 2015 emergency meeting of Eurozone finance ministers resulted in a four month extension of Greek loan repayments, providing a financial lifeline to prevent the country from going into bankruptcy and potentially creating further market destabilization in the Eurozone (New York
While Greece was allowed some flexibility on its repayments, the negotiations still hinged upon its continued dedication to austerity and fiscal discipline (New York Times, 2015a).

Critics on the left claim that the EU’s acknowledgment of the harm caused by austerity and the need for a pro-growth agenda has been largely symbolic and has not been met with substantial policy changes (Reuters, 2013). This indicates that there is no universal consensus over how the crisis should be addressed. In fact, rather than a broad uniform policy for all member states, austerity programs will likely need to be tailored to each state in order to address specific national economic needs. This will mean that a careful balance of economic stimulus to promote growth, coupled with longer-term deficit-cutting and structural domestic reforms, by debtor countries, as well as higher spending by creditor countries may be necessary (Wall Street Journal, 2015). Achieving this balanced policy approach will require compromise and consensus among a range of different political factions. However, the politicization of post-crisis social and economic policies may instead prolong the economic recovery as ideological standoffs continue. If so, the lack of economic growth and worsening social conditions, particularly within Europe’s peripheral countries, may generate increasingly radical political positions, which will make consensus even harder to achieve.

Conclusion

In sum, ideologically-infused politics have become increasingly important in the post-crisis period in defining both European economic recovery strategies and social spending. If the pre-crisis period was defined by elite level political consensus over neoliberal policy tools, with liberal welfare strategies being adopted across a number of different member states, these policies and their ideological underpinnings have been subject to far more scrutiny and debate post-crisis. This
signifies an important change in the dynamics shaping social and economic policymaking since the onset of the crisis. While EU membership was positively correlated with welfare state retrenchment pre-crisis, this relationship no longer holds in the post-crisis period. In large part, this change is due to the increases in stimulus spending undertaken by member states and encouraged by EU institutions in the early stages of the crisis to address negative social and economic effects. This said, further European economic and financial market integration after the crisis had significant spillover effects on domestic social spending levels. Specific policies, most notably the 2012 Fiscal Compact, put pressure on member states to reduce government debt and deficit levels, which often translated into large social spending reductions.

Initially there was political consensus between member states and EU institutions, in the aftermath of the crisis, on the need for increased stimulus spending and more European financial market oversight mechanisms and economic regulations. However, as the crisis has worn on considerable political conflict has emerged over the best long-term solutions to restore growth and stability to the region. The dividing line in this conflict has largely been between proponents of austerity and advocates of short-term stimulus strategies. This political division highlights the continued asymmetries between economic and social policies within Europe. Although social concerns continue to be identified as a key element of European policy objectives, critics argue that the strict focus on economic goals and fiscal discipline have undermined the European Social Model and led to increased political instability across the region (Foreign Policy, 2015). Economic reforms aimed at establishing fiscal discipline and market stability are seen as essential, but critics say they must be coupled with strong social benefits to counteract the negative effects of economic downturn, such as rising unemployment and social inequality, which threaten to prolong the recession and create further political instability.
This political conflict has occurred between national governments and EU institutions, it has taken the form of intense interstate conflict, and it has occurred between political parties at the domestic level. The coming chapters explore five country case studies in order to analyze in greater detail the domestic political factors which have shaped social spending across an array of different welfare systems. In doing so, these cases will examine the important ways in which the distinct social protection institutions within different countries mediate these political debates.
Chapter 5: Germany

In addition to incredible sweeping changes initiated by the global economic crisis at the European level, the economic aftershocks of this event have had profound effects on social, economic, and political conditions across EU member states. While all countries were affected by the sharp economic downturn, the crisis management responses of national governments and subsequent social and economic outcomes have differed significantly between states. These divergent results have been largely driven by the specific political variables and institutional structures within states, rather than the severity of economic crisis itself (Farnsworth and Irving, 2011). This chapter explores the political dynamics and social spending outcomes in Germany during the pre- and post-crisis periods. Germany is a representative case study of a Continental European welfare state, and is often identified in the literature as a classic example of this ideal regime type (Esping-Andersen, 1990, 1999; Häusermann and Palier, 2008; Pierson, 1996, 2001).

Of course, Germany is also a major, perhaps dominant, economic and political power within the EU, and as such is a valuable case study for the purposes of analysis. The following sections will explore broad changes in the pre- and post-crisis social spending in Germany and examine the critical role that politics has played in shaping these outcomes. First, this chapter will investigate German welfare policies in the decades building up to the global economic crisis. In doing so, this research will identify the social spending patterns and politics that defined this timeframe. Second, I will analyze the early stimulus response undertaken by the German government in the immediate aftermath of the global financial crisis. In particular, this section will highlight the important role that social protection systems played in shaping the types of stimulus measures adopted by the German state. It will also identify the important break that these policies represents from earlier social spending patterns. Finally, I will examine the increasingly important role that political
variables have played in defining the long-term German social policy response. These political factors have not only been instrumental in shaping social spending domestically, but they have been highly influential in defining the policy position that Germany has taken in deliberations with EU authorities and other European member states. In many respects, German political dynamics have been instrumental in defining the post-crisis social and economic policy debates within Europe, setting advocates of fiscal discipline and austerity against proponents of a pro-growth agenda.

**German Welfare State Pre-crisis**

*Social Policy Liberalization*

A shift in government social policies is clearly evident in Germany from before and after the start of crisis. Whereas the welfare system in Germany, historically, has been predicated on a conservative tradition in which the core workforce is well protected and receives generous social benefits, a number of liberal reforms were introduced during the timeframe prior to the crisis. From 2002 through 2004 the German government adopted a number of legislative measures, known as the Hartz reforms, which lowered unemployment and social benefits for core workers and introduced new activation policies to encourage labor market access for outsider groups (Seeleib-Kaiser and Fleckenstein, 2007). Unemployment insurance, for example, was lowered from three years to one, representing a significant reduction in benefit levels for regular workers (Dribbusch, 2004). Additional social benefits for families were implemented as a means to encourage female workforce participation and move away from the traditional male breadwinner model (Lewis et al., 2008).
While some groups resisted what they saw as an attack on the traditional protection measures enjoyed by labor market insiders, the changes they were largely introduced with minimal political conflict (Streeck and Trampusch, 2005; Thelen, 2009). In part, this is due to the fact that the introduction of these liberal reforms did not constitute a wholesale overhaul of the social protection system, and considerable protection and benefits for core workforce remained intact (Thelen, 2009). Skilled workers in core industries, such as manufacturing, and those working in large firms, for instance, continued to benefit from strong employment protection and social benefits (Thelen, 2009). In fact, a main focus of economic policy debate immediately preceding the crisis concerned a shortage of skilled workers in firms (Möller, 2010). This signaled that, although the Hartz reforms lowered unemployment benefits, skilled workers would largely be unaffected by these changes as it was highly unlikely that they would remain unemployed for more than a year. Instead, the most obvious losers under the new legislation were low skilled laborers and the long-term unemployed, indicating the continuance of labor market dualization (Thelen, 2009). As a result, while there was an initial nationwide outcry against the Hartz reforms, these demonstrations became increasingly smaller and concentrated within certain regions as the legislation came into force (Dribbusch, 2004).

There are two important lessons to draw from the Hartz reforms. First, these legislative proposals constituted the introduction of liberal policies into the German welfare state and labor market coinciding with more widespread pro-market reforms throughout the OECD. In fact, the prevailing logic of neoliberalism dominated the political debate over social policy and labor market reforms at this time, promulgated at the international level by organizations including the IMF, the OECD, and the EU. The 1994 *OECD Jobs Study* and the 1997 *European Employment Strategy*, for example, provided authoritative guidelines for the types of liberal reforms which states should
implement (EU, 1997; OECD, 1994). This neoliberal policy approach appeared to be influential across parties in Germany who supported the necessity of these reforms given the high levels of unemployment and slow economic growth that persisted in the country at the time. It is important to recognize, however, that these reforms did not constitute a convergence of the German welfare state toward a Liberal social welfare model, but rather represented incremental liberal reforms intended to promote competition, efficiency, and economic growth.

Second, these liberalization policies were largely depoliticized as they enjoyed widespread support across political parties. The Hartz reforms built upon earlier liberal labor market and welfare reforms introduced by a center-right coalition government consisting of the Christian Democratic Union (CDU) and the Free Democratic Party (FDP) (Zohlnhöfer and Herweg, 2012). The Hartz reforms themselves were introduced by a left leaning Social Democratic Party (SDP) and Green Party coalition government, led by SPD Chancellor Gerhard Schröder (CEPS, 2014). Subsequent liberal labor market reforms introduced in 2006 under a new coalition government led by the CDU and SDP lowered the maximum period for claiming unemployment further (CEPS, 2014). Overall, there appears to be fairly widespread acceptance of these liberal social policy reforms across all major German political parties during the pre-crisis period. Using statistical analysis to identify the effects of political party ideology on social expenditures in Germany prior to the crisis, Niklas Potrafke finds that politics had little effect in shaping social policy outcomes. In fact, policies implemented by both left and right governments were quite similar in nature (Potrafke, 2012).

Overall, research suggests that social spending in Germany prior to the crisis was not politically controversial. Seeleib-Kaiser et al., for example, find that prior to the crisis differences in the social policy positions of the two dominant parties in Germany, the center-right CDU and center-left
SPD, had nearly disappeared (2008). Additional case studies indicate that the social policies of CDU and SPD were similar in nature before 2008 (Potrafke, 2012; van Kersbergen, 1995). Survey evidence suggests that even many citizens who were otherwise not overwhelmingly supportive of liberal policies saw these reforms as necessary and the best means to address the problems of low economic growth and high unemployment (Zohlnhöfer and Herweg, 2012). In sum, social policy decision-making during the decades preceding the crisis was largely defined by the introduction of incremental liberal reforms to social and labor market policies, which achieved widespread support across political parties.

**German Welfare State Post-crisis**

*Crisis Management Stimulus Measures (2008-2010)*

In contrast to the pre-crisis timeframe, in which social policy liberalization had become the norm, social policy expenditures in the immediate aftermath of the crisis were much more in line with traditional Continental European welfare state expectations. In other words, it appears that the social welfare system in Germany was highly influential in defining the government’s social and economic policy response in the period immediately following the crisis. Whereas nearly all countries throughout the OECD adopted some form of counter-cyclical stimulus measures in the early stages of the crisis, these expansionary spending responses did not constitute a convergence of policymaking across states. In some ways this is surprising given the overwhelming trend among OECD welfare systems toward liberalization in the pre-crisis period and the similarities in the nature of the problem faced by states at the onset of the crisis. In fact, the strategies and specific types of social spending measures implemented by various states were highly influenced by existing welfare arrangements. Although as the crisis progresses we will see the growing important
that political factors would play in shaping long-term social spending outcomes. The early crisis responses of governments, however, seem to reaffirm the importance of welfare system institutional legacies in shaping social policy decisions, rather than reactionary spending being dictated purely by exogenous economic conditions. While the financial crisis triggered government interventions in the form of large fiscal stimulus packages, the makeup of these measures varied considerably between states. These crisis management policies mostly fell in line with the social spending patterns associated with existing welfare systems in countries.

In the weeks and months after the onset of the financial crisis, the German government undertook a series of stimulus measures designed to ensure the continued employment of labor market insiders and the preservation of skilled labor in the workforce. As discussed earlier, both strategies are key elements of the Continental European welfare system approach to protecting citizens during times of economic strife. This strategy which relied on active state intervention in the labor market was in stark contrast to the approach of Liberal welfare states, such as the UK, which pursued more market-based approaches, such as offering subsidies and other incentives for firms to hire workers (Chung and Thewissen, 2011). The German social policy response instead reflected a corporatist strategy in which tripartite negotiations between the government, labor unions, and employers allowed workers to agree to wage restraints and reduced work hours in exchange for guaranteed job security. This social partnership between the government and the main actors within the economy was integral to developing a strategy to reduce unemployment in Germany after the crisis. This approach is a prominent example of the German government’s reliance on existing non-market coordinating mechanisms, rather than market based strategies, to mitigate the effects of the crisis. The initial stimulus response of the German government,
therefore, represented a break from the liberal social policies adopted during the pre-crisis period and a return to more traditional Continental European social protection strategies.

In early 2009, the German government introduced two economic stimulus packages with a combined value of over €80 billion. The first package, titled ‘Securing Jobs by Strengthening Growth’, provided €31 billion in government funds to support domestic financial markets and the hard hit manufacturing sector, as well as provide long-term investments in public goods (Chung and Thewissen, 2011). The second stimulus package, titled the ‘Pact for Employment and Stability in Germany’, provided around €50 billion in government funds to reduce tax burdens, bolster consumer demand, and encourage investment (Chung and Thewissen, 2011). Included in these stimulus packages was an agreement that the federal government would provide funds to supplement employment costs in return for a pledge by Germany’s largest firms to avoid mass job cuts (Jackson, 2009). In order to protect the core workforce, the government worked with labor unions and firm representatives to modify an existing tripartite agreement to extend benefits and provide additional funds for short-time work schemes (ILO, 2009). The agreement allowed employers to lower labor costs by reducing the number of work hours and wages of employees as demand worsened, without the need for layoffs. Reduced wages were paid out by the government as partial unemployment benefits so that workers did not see a remarkable decrease in their wages. These measures enabled employers to maintain their skilled workers, in return for guaranteeing job safety and training for employees. From 2008 to 2009, the eligibility period for these short-time work schemes was temporarily extended from 6 to 24 months, during which time over 3% of the entire workforce was enrolled in these programs (EIRO, 2009a, 2009b, 2009c, 2009d, OECD, 2010a).
Short-time work schemes were an important alternative to layoffs as the German labor market coped with the decline in international demand for goods and services. These schemes promoted temporary reductions in working time by providing wage replacement benefits for employees who worked less than their normal hours. These policies represented a significant protection against the effects of the economic downturn. In fact, the extensive use of short-time work schemes is largely credited for the low unemployment rates in Germany since the beginning of the crisis, despite an overall decrease of demand in the international market and slower economic growth (Chung and Thewissen, 2011). According to research conducted by Joachim Möller, the number of jobs saved by short-time work schemes was the equivalent of approximately 360,000 employees (2010).

A second important feature of the renegotiated tripartite agreement was the allowance of greater flexibility in the management of the working-hours account model. The working-hours account model allowed employers to decrease staff costs without having to make job cuts during the recession by reducing the working hours of employees and limiting the need for overtime. This reduction of work time was one of the main factors providing a buffer against the collapse in demand for goods due to the economic downturn. Reduced staff hours, due to flexible working accounts and a reduction in overtime, allowed for a shock absorption equivalent to approximately 529,000 employees (Möller, 2010). This represents a significant number of retained jobs due to the non-market coordination of employment. Combined, flexible working accounts, short-time work schemes, overtime reductions, and other work time policies accounted for a reduction in working hours equivalent to 1.39 million full-time employees (Möller, 2010). These measures principally helped to protect core labor market positions, particularly jobs within the male-dominated manufacturing industry (Eichhorst et al., 2010; EIRO, 2010a).
Another measure included in both stimulus packages was the expansion of an early retirement scheme for older employees (European Commission, 2009a). These policies were designed to help older workers, over 55 years of age, gradually transition into retirement, which would allow for the opening up of new job positions. If an employee above the 55 year age requirement agreed to reduce his working time by half, the employer would pay only 70% of the employee’s reduced wage and pension schemes and the federal government agreed to pay the additional wage and pension costs (EIRO, 2009e). This arrangement ensured that the pensions and retirement of the older workforce could be safeguarded, while allowing more positions to be filled by younger workers. The stimulus packages also introduced a number of activation policies intended to increase skill levels within the workforce through investments in on-the-job training and job placement programs (Chung and Thewissen, 2011). In an attempt to encourage greater female workforce participation, the stimulus packages included several family support policies, including a 4.3% expansion of universal child benefits and a tax-free child allowance (European Commission, 2009a).

In sum, at the start of the crisis, the German government adopted a series of reactive stimulus measures designed to stabilize financial markets, bolster economic growth, and ensure the protection of a highly skilled core workforce. These extensive fiscal stimulus measures were very much in line with prevailing Continental welfare system approach based on wage protection and a focus on the core labor force, rather than representing a continuation of the liberal policies which had dominated the two decades preceding the crisis. As a whole, the stimulus measures primarily benefitted labor market insiders. Short-time working schemes, for instance, were targeted at permanent core workers at the expense of their temporary counterparts (Cho and Newhouse, 2013; Lim, 2000). Collectively agreed upon provisions to bolster social policies were
also more likely to cover employees with standard contracts or those working in large firms (Glassner and Keune, 2012; Leschke and Jepsen, 2012, 297). Although some additional measures were introduced to encourage greater workforce activation of labor market outsiders, such as women, these groups were not the primary beneficiaries of these measures. For instance, out of 1.4 million short-time workers registered in Germany in June 2009, 78% were men (German Federal Employment Agency, 2009, 9-12).

Although stimulus social spending bolstered the existing welfare protection system, in which prominent insider/outsider divides persisted, some means-tested benefits were introduced to eliminate poverty and provide basic services to outsider groups. New social protection policies targeted toward outsiders, such as family policies and activation measures, were added alongside existing welfare provisions. While they did little to alter the welfare institutional arrangement or address the problem of dualization, these measures helped to alleviate the growing conditions of poverty among the non-traditional workforce (Mahoney and Thelen, 2010; Streeck and Thelen, 2005; Thelen, 2009).

In addition to a series of active social spending measures put in place by the federal government to safeguard citizens, the German welfare state maintains a number of automatic stabilizing mechanisms to ensure that social spending increases to meet the needs of the population as economic and social conditions worsened regardless what other measures the government takes in the immediate wake of the crisis. According to research by Dolls et al. (2012), automatic stabilizers in Germany absorbed 48% of the income shock and 62% of the unemployment shock generated by the economic crisis, well above the EU average. These generous social transfers, in combination with fiscal stimulus measures, played a key role in stabilizing disposable incomes and household demand within the economy. As a result, although Germany was considerably
affected by the sharp economic downturn brought on by the crisis, in its aftermath the country remained on relatively good social, economic, and financial footing.

Unlike the US and UK, whose economies rely heavily on financial market services, the German economy was not as hard hit by the earliest wave of financial crisis. However, as the crisis wore on lowered demand for exports began to have a negative effect on German economic growth. Even so, the high levels of employment protection, generous automatic stabilizers, and strong reactive crisis management policies kept unemployment considerably lower in Germany than the rest of the OECD. In fact, not only has the German labor market fared far better than most its European counterparts, it saw lower unemployment throughout the crisis than in the two preceding decades. The average unemployment rate in Germany from 1990 until the beginning of the crisis in 2007 was 8.73%, with a high of 11.3% in 2005 (OECD, 2015b). In the aftermath of the crisis, however, the average unemployment rate was 6.2% reaching 5% in 2014, the lowest since national reunification (OECD, 2015b).

This positive labor market performance has been highly important because, while problems of dualization persist, the relatively low levels of post-crisis unemployment ensured that political conflict between labor market insiders and outsiders did not intensify. High levels of employment also ensured that employee contributions to social programs remained high. This has allowed the government to introduce gradual welfare reductions, rather than facing the need to make drastic cuts to social programs due to budgetary constraints. As we will see, this latter scenario has been a considerable problem in Southern Europe and parts of Eastern Europe, resulting in higher levels of social dislocation and intensified political conflict. In many respects, the size and scope of the German welfare state has helped to limit domestic political conflict and reduce social and economic hardship, even among less protected outsider groups.
As a result, in the aftermath of the global economic crisis, Germany has not seen the same degree of political volatility and turnover that has occurred in many OECD countries. In fact, not only has Angela Merkel’s CDU party remained in power, in the 2013 national elections the CDU and its sister party the Christian Social Union (CSU) won an overwhelming majority with 41.5% of the vote (Parties and Elections, 2015). The Chancellor not only secured a historic third-term electoral victory, but came just five seats short of an absolute parliamentary majority (Guardian, 2013a). According to many analysts this strong margin of victory signifies a prominent sentiment among German citizens that they were well protected from the crisis under the CDU’s leadership (Guardian, 2013a) and is in stark contrast to political trends throughout the rest of the Eurozone, where ruling parties have been voted out of power in 12 of the 17 members states (Guardian, 2013a). In fact by 2012, the ruling governments in more than half of the EU’s 28 member states were forced to end their terms prematurely or were voted out of office (Deutsche Bank 2012; Deutsche Welle, 2012; Regan, 2012). In most cases, deteriorating social and economic conditions combined with public perceptions of the government’s inability to effectively address the crisis and provide adequate protection for citizens have been the driving forces behind these political changes (Deutsche Bank, 2012; Regan, 2012).

Politics, Fiscal Discipline, and Austerity

While Germany has not been faced with the high degrees of domestic political conflict seen in some EU member states, political factors have been important in driving post-crisis social policy outcomes. Although the initial crisis management response of the government took the form of fiscal stimulus spending increases, as the crisis has worn on Germany made reductions in social spending and introduced a series of incremental austerity measures. These policies are intended to
exercise fiscal constraint. In the early stages of the crisis, rapid stimulus measures were seen as necessary to support financial sectors, restore market confidence, bolster employment, stimulate domestic demand, and provide social protection. As the economic crisis persisted, however, budgetary constraints and growing debt and deficit concerns forced political actors to make important decisions about how to address the long-term effects of the recession. Informed by neoliberal economic rationale, the ruling center-right CDU party has taken the position that fiscal discipline and retrenchment are the best means to lower the national debt and restore confidence in the economy (EUCE, 2013). Due to its relatively stable economic footing, German austerity measures have been more gradual and minor in nature than in other EU member states. This has resulted in far less political conflict and social instability than in other harder hit countries. These austerity measures, however, do mark an important return by the German government to liberal economic principles and a shift from short-term expansionary spending to longer term fiscal discipline as a strategy to address the ongoing crisis.

Austerity measures and government spending reductions are key elements of the CDU party platform and have played a critical role in defining the policy positions of the state both domestically and in EU crisis management decisions. As the crisis has progressed, many domestic political constituencies within Germany saw austerity as the best strategy to address the crisis. By 2011, the center-right coalition of the CDU and FDP introduced a budget package which aimed to reduce government spending by nearly $100 billion between 2011 and 2015 (EUCE, 2013). Included in the budget were measures to eliminate over 10,000 public sector jobs, reduce government payrolls, lower child services payments, and scale back unemployment benefits (EUCE, 2013; Market Watch, 2010). In the build up to the 2013 national elections, Merkel and the CDU announced additional cuts to government spending worth up to nearly $8 billion, with the
goal of balancing the budget in the coming years (CNBC, 2013). In the 2013 report, "Medium-Term Budget Goals of the Federal Government" the Federal Ministry of Finance, led by Wolfgang Schäuble, advocated for additional cuts in social services, including almost $11 billion in reductions to the national health fund, reductions in pension payments for early retirement, and a $2 billion cut in the government's contribution to the pension system (Spiegel, 2012a, 2012b). Following the same trend, the 2014 Federal Budget presented by Mr. Schäuble included an additional $5.4 billion in spending cuts, including cuts of several hundred million euros to the Federal Employment Agency budget, and caps for the parental leave allowance program (Financial Times, 2013). The overall goal of these reductions was to establish a balanced budget by 2016 and for Germany to serve as a leading example for other European states to follow (Spiegel, 2012b).

In many respects these reductions in government expenditures and fiscal consolidation policies put forth by the CDU are in keeping with the expectations of Christian Democratic parties found in the welfare state literature (Iversen and Soskice, 2012). Namely that, PR systems with strong a CD party presence are anticipated to generate more center-right leaning coalitions which advocate for lower levels of redistribution and social support than PR systems without a large CD presence (Huber, Ragin, Stephens, 1993; Iversen and Soskice, 2006, 2009, 2010; Swank, 2013). Similarly, the expectation is that in response to economic shocks electoral systems with a strong CD presence will provide lower levels of social spending and fewer public employment opportunities (Iversen and Soskice, 2009, 2010). The policies of the German CDU party seem to confirm these theoretical expectations and provide a compelling example of the importance that politics play in defining the post-crisis social policy response of national governments.

In addition to influencing German social spending in the post-crisis period, the center-right CDU political coalition has been instrumental in reducing domestic conflict, particularly between
constituencies from different income levels. Christian democratic parties, are based on cross-class coalitions that represent the interests of a wide range of groups, including low-income workers, middle-income skilled workers, and upper-middle class professionals (Iversen and Soskice, 2006, 2009, 2010). Manow and van Kersbergen conceptualize Christian democratic parties as “negotiating communities” in which groups from various income levels and economic interests coordinate to achieve shared interests (2009). Representing a wider coalition of interests across the center of the political spectrum, parties like the CDU are able to draw skilled workers and middle-income voters away from traditional left parties at the same time that they draw higher income voters away from more conservative parties (Iversen and Soskice, 2006, 2009, 2010). In other words, one reason for the subdued domestic political conflict between parties in Germany has been the ability of the CDP to reach a wide-range of constituents. This is evidenced by Chancellor Merkel’s phenomenal electoral success and her party’s ability to stay in power since the beginning of the crisis.

As a result of these dynamics, rather than negotiations over social spending and redistributive preferences in Germany taking the form primarily of interparty conflict between parties on the left and right, much of the bargaining between different interests takes place internally within the CDU (Iversen and Soskice, 2006, 2009). Iversen and Soskice argue that in electoral systems with a strong Christian democratic presence, social democratic parties will shift their strategic focus toward the political center and effectively abandon their lower income constituencies (Iversen and Soskice, 2010). This indicates that political dividing lines become more muted as parties seek to gain support over centrist issues. The combination of a cross-class CDU coalition and debates which are oriented around the political center, effectively limits the access of labor market outsiders making them less of a political threat (Iversen and Soskice, 2006, 2009, 2010). In other
words, it becomes harder for outsider groups to gain the mainstream support of other economic classes. As a result, we have not seen the same degree of polarization and widespread populist left-leaning uprisings in Germany that we have seen in countries like Spain, Italy, or Greece.

It is important to note however, that we see some dissent internally among political parties. Within German domestic politics there is clear support for fiscal discipline and austerity among the leading CDU and CSU political parties. This position has also been widely supported by the FDP, a political party which has long been in favor of neoliberal policy proscriptions, including reduced taxes, deregulation, and low government debt (ECFR, 2012). However, whereas the leading Social Democratic opposition party had been largely in favor of neoliberal social and economic reforms in the pre-crisis period, most notably passing the Hartz IV labor market and welfare reforms while in power in the mid-2000s, the SPD has shifted its position in the aftermath of the economic crisis calling for greater government intervention and policies which, although set some fiscal limits, emphasize growth over austerity (ECFR, 2012).

Similarly, although the SPD largely refrained from using fiscal policy to stimulate growth while in power in the pre-crisis period, it was a leading architect of the stimulus package put forth by the CDU/SPD coalition in response to the crisis, claiming many of the policies as its own (ECFR, 2012). After the 2009 general elections the SPD left the grand coalition with the CDU, moving politically even further to the left. While recognizing the need for a certain degree of fiscal discipline, the SPD has been far more in favor of social welfare expansion and higher taxes to pay for public goods (ECFR, 2012). The Social Democrats have also been more critical of the effects that austerity measures will have for economic growth prospects domestically and throughout Europe, calling instead for policies that promote growth and investment (ECFR, 2012). A visible change in the SPD’s policy position, since the start of the crisis, has been its shift in position over
the official retirement age. While a member of the grand coalition with the CDU/CSU from 2005 until 2009, the SPD had been in favor of establishing the age of retirement at 67 years (Potrafke, 2012). However, in 2010 the SPD came out against this policy and instead sought to lower the age of retirement, indicating a move toward more generous social policies (Potrafke, 2012). Since the onset of the crisis, the two other major political parties in Germany, the Green Party and Liberal Party, have also favored more government expenditures on social programs and placed an emphasis on growth over strict austerity (Armingeon and Baccaro, 2015; ECFR, 2012; Hübner, 2013). Overall, while social spending was largely depoliticized in Germany before the crisis, with all of the major parties favoring some form of liberalization (Potrafke, 2012), welfare spending decisions have become subject to more political debate in the aftermath of the global economic crisis.

**Domestic Politics and EU Austerity**

These domestic political dynamics have also had a profound effect on the position of the German government in its negotiations with other member states and EU institutions over how best to address the Eurozone crisis. The presence of a strong CD party in Germany has been influential in shaping its social policy response to the crisis both domestically, in the form of modest social welfare cutbacks, and internationally in defining the German policy position for a European recovery. From the perspective of the CDU, the primary causes of the sovereign debt crisis that have wreaked havoc throughout the Eurozone stemmed from lack of fiscal discipline among profligate member states (Armingeon and Baccaro, 2015; ECFR, 2012). This belief has been echoed by both the CSU and FDP who share a similar conservative view of the causes of the debt crisis. By framing the Eurozone debt crisis as a problem of discipline and irresponsible borrowing
by specific member states, the CDU and its conservative allies discounted opposing claims that the crisis stemmed from the structural arrangement of the currency union and the imbalances that exist within the Eurozone (Armingeon and Baccaro, 2015). As a result, alternative policies seeking to address such structural concerns are downplayed, and the CDU instead called for austerity measures, fiscal limits, and domestic reforms as the most sensible and effective means to address the crisis. Its argument is that immediate budget consolidation, through reductions in government expenditures, will reduce the risk of insolvency, thereby, bolstering market confidence allowing states to borrow more easily and invest in growth in the long-term. From this perspective, austerity measures and fiscal discipline, rather than prolonging economic downturn, are keys to ensuring growth (ECFR, 2012).

The CDU led German government has been a leading advocate for austerity within the EU. In many respects, the emphasis on fiscal discipline and structural reforms, which are prominent features of the EU’s response to the debt crisis, reflect German policy preferences, rather than a collective agreement among all member states. For example, the constitutional limits on national budget deficits which are a mandatory component of the 2012 Fiscal Compact are modelled on the German Schuldenbremse or “debt brake” mechanism established in the German constitution in 2009 (Armingeon and Baccaro, 2015; Economist, 2011; ECFR, 2012). Strict structural reform conditions for countries requiring bailouts to manage their domestic debt problems have also been largely supported by Germany and other conservative allies (EUCE, 2013). In addition to ensuring that austerity and fiscal discipline are enshrined in the EU’s crisis response policies, the German government has also opposed measures toward debt mutualization and the purchasing of government debt in the form of bond buying schemes. The CDU has argued against establishing common European debt assurances, in the form of Eurobonds, citing the so-called “no bailout”
clause in the Maastricht Treaty, which specifies that states should not be liable for, nor assume, the commitments or debts of any other member (CFR, 2010; ECFR 2012). In a speech to the German Parliament in 2012, Merkel went so far as to announce that there would be no full European debt sharing or the establishment of Eurobonds, "as long as I live" (Spiegel, 2012c). CDU officials worried that such measures would create a moral hazard and create disincentives for debt-stricken countries to undertake necessary structural reforms. From this perspective, these policies would ultimately require German citizens to foot the bill for the poor economic behavior of other Eurozone members.

Identifying similar concerns of moral hazard, the CDU led German government has also come out against the ECB's bond buying schemes (ECFR 2012). When in 2012 Mario Draghi, head of the ECB, announced that the central bank would initiate a program of purchasing the government bonds of struggling Eurozone member states in order to lower their borrowing costs and offer a degree of debt relief, it had the effect of calming international financial markets, but was met with widespread opposition by many German government officials (Bulmer, 2014; Spiegel, 2012d). Jens Weidmann, the head of the Bundesbank, Germany’s central bank, and a prominent member of the ECB Governing Council, for example, has repeatedly opposed the ECB’s bond purchase plan considering the program to not only threaten the European recovery effort, but arguing that the policy was anathema to the founding principles and traditions of the Bundesbank (Financial Times, 2012; Wall Street Journal, 2012b). Prominent members of the CDU, including deputy parliamentary floor leader Michael Fuchs, have also come out against the ECB’s bond purchasing scheme arguing that the central bank should encourage struggling Eurozone members to continue reform efforts, rather than providing cheap money that might discourage the need for such restructurings (Reuters, 2015b). Despite German opposition, the ECB has gone ahead with its
program to purchase sovereign debt, which from March 2015 until the end of September 2016 introduced €60 billion ($68 billion) a month into the EU economy and provided more than €1 trillion in total (Reuters, 2015c). However, while unable to halt the bond buying program from moving forward, German pressure has led the ECB to adopt certain provisions, for example, only allowing countries who agree to austerity conditions to apply for bailout funds (Spiegel, 2012e).

Overall, the fact that so many of the key policy responses of the EU have been predicated on the German belief in the necessity of austerity, speaks to the power and influence that Germany holds within the European policymaking process as the engine of economic growth in the region and leading lender state. In no small part, Germany's degree of influence over EU policymaking and its ability to advocate for setting strict fiscal conditions on other states is due to the fact that it is the largest contributor to the Eurozone bailout funds (Bulmer, 2014). It also speaks to the powerful role that political parties play in defining social and economic policymaking within the EU. Though the German government, under the leadership of Angela Merkel, has been one of the leading advocates of austerity it has gained support from other center-right governments in the Eurozone, including the Netherlands and Finland, both of whom have strong CD parties within their political systems. Together these states have promoted a pro-austerity agenda which has placed pressure on highly indebted peripheral states, such as Greece, Italy, Ireland, Portugal and Spain, to introduce social spending reductions, rather stimulus measures to support domestic demand (EUCE, 2013). The presence of conservative political parties has also led to domestic social spending reductions in other countries, such as the UK, who have supported efforts to cutback welfare state spending both domestically and at the EU level (EUCE, 2013).

To emphasize the importance that the CDU, and its center-right political coalition, has played in defining European social and economic recovery efforts, it is useful to examine the alternative
positions of other German political parties. In many respects, the SPD, the leading opposition party in Germany, has favored a different approach to the European crisis management solutions. Whereas the CDU, CSU, and FDP have all signaled the singular importance that austerity must play in European economic recovery efforts, largely ignoring claims that such policies represent a burden on growth, prolonging the crisis and generating worse social conditions, the SPD has been more receptive to the need to couple fiscal discipline with a pro-growth agenda. For example, in 2013, Martin Schulz, president of European Parliament and a leading SPD official, appealed to Angela Merkel to change her party’s position vis-à-vis European recovery, arguing that more consideration should be given to the social and economic hardships faced by struggling peripheral Eurozone members (Spiegel, 2013b). The appeal was an attempt to sway the CDU to eschew its hard line emphasis on austerity and acknowledge that more needs to be done to address social concerns, such as high youth unemployment and growing wage disparities among EU countries, particularly in hard hit Southern Europe (Spiegel, 2013b).

While the SPD has supported some of the fiscal constraints proposed by the CDU since the beginning of the Eurozone crisis, for example backing the Stability and Growth Pact, the Fiscal Compact, and the adoption of constitutional debt brake mechanisms across member states, the party has also been more critical of strict austerity strategies (Armingeon and Baccaro, 2015; Hübner, 2013). The German Social Democrats have shown considerable support for the ECB’s bond buying quantitative easing program, a position which both the Greens and Left Party have been in favor of as well (Armingeon and Baccaro, 2015; Hübner, 2013). There has also been some support among SPD members in favor of the idea of establishing a mutualized European debt mechanism, such as Eurobonds, however this position has not been as strongly supported by the
party as a whole in large part due to negative public reactions against the policy (ECFR, 2012; EU Observer, 2014; Policy Network, 2015).

It is impossible to know exactly how an alternative governing coalition led by the SPD and its left-wing allies would affect Germany’s domestic and European policy positions. Evidence, however, seems to suggest that although support for stricter fiscal rules might continue, perhaps greater credence would be given to policies favoring more expansionary spending to address rising social inequalities and encourage growth. In other words, the German negotiating position in regards to European social and economic recovery strategies would potentially undergo a significant shift if a change in domestic political leadership were to occur (ECFR, 2012). While this event is very unlikely, given high level of support that Angela Merkel’s administration received in the most recent national elections, this scenario highlights the critical role that the CDU has played in shaping the German government’s response to the crisis. The fiscal discipline which the CDU has encouraged has in many ways shaped European recovery efforts and has been a defining feature of the political debate in Europe placing stalwart supporters of austerity against left-wing supporters of a pro-growth strategy.

**Conclusion**

The initial shock of the global economic crisis triggered immediate social spending increases in Germany, representing a break from the liberal policies and spending reductions introduced in the past two decades. This event has also led to increased political divisions and debates over the reintroduction of long-term liberal policy solutions to the ongoing crisis. This political conflict can perhaps most clearly be seen in the interstate struggles that have occurred between Germany and the highly indebted peripheral states in Europe. During the pre-crisis timeframe, neoliberal policies
were introduced to welfare systems and labor markets across Europe and were met with widespread political support. In the wake of the crisis, policies advocating for further welfare retrenchment have been met with considerable resistance and political debate. This political sea change has placed Germany’s conservative CDU party, and its pro-austerity center-right allies, in direct conflict with other member states particularly in Southern and Eastern Europe who face the burden of these policies. At times this political divide has also put the German government in direct conflict with EU institutions who have raised some concerns about the negative effects of a strict austerity agenda. Domestically, although Germany has not seen the political upheaval and overturn of the ruling political party, which has occurred in a number of EU member states, differences have emerged and grown between political parties who once shared similar policy preferences. Most notably the SPDs move toward more left-wing policies favoring pro-growth strategies as an alternative to the strict austerity approach favored by the CDU. In sum, long-term social spending solutions to the crisis have been considerably influenced by the political dynamics that operate in Germany, a notable change from earlier period of economic stability.
Chapter 6: The United Kingdom

From an institutional perspective, the UK is often cited as classic example of a liberal welfare state, which relies on means tested social programs targeted towards at-risk populations (Esping-Andersen, 1990; Häusermann and Palier, 2008; Pierson, 1996, 2001). The UK is also a significant global economic actor with a large financial market and banking sector heavily affected by the economic crisis. In the aftermath of this event, the British government has been a front-runner within the EU in pursuing fiscal discipline and welfare retrenchment policies. As such, the UK is another important case study for analysis to understand how the global economic crisis has reshaped the politics of social spending across OECD countries.

This chapter will explore the shifting trends of social spending in the UK from before and after the global economic crisis, paying close attention to the role that political variables have played in shaping these outcomes. The chapter will begin by examining UK social spending in the two decades prior to the start of the crisis, which was notable for the widespread acceptance of liberal welfare policies across political lines. The next section will examine the immediate stimulus package adopted by the UK government in response to the global financial market collapse. In particular, this section will identify how this stimulus response represents an important break from earlier social spending patterns. Finally, I will examine the increasingly important role that politics has played in defining the long-term post-crisis social spending in the UK. I argue that not only have political variables been the key drivers of domestic social spending, but that since the onset of the crisis these factors have taken on increased importance in defining both the long-term crisis response of the UK welfare state and the British position in EU social and economic debates.
UK Welfare State Pre-crisis

Social Policy Liberalization

In the two decades building up to the economic crisis, the UK government oversaw the transition of the welfare state from a model of passive social assistance toward one emphasizing workforce activation and social investment strategies. This adoption of liberal market policies into the social sphere was achieved with widespread support across political parties. Historically political divisions in the UK have existed between parties on the left, who favored a strong welfare system and social spending expansion, and parties on the right favoring a smaller and more efficient welfare state (Allan and Scruggs, 2004; Boix, 2000; Huber and Stephens, 2001; Korpi and Palme, 2003; Taylor-Gooby, 2001). In the two decades preceding the global economic crisis, however, these political divisions were largely muted as an ascendant neoliberal policy agenda was embraced by parties on both ends of the political spectrum (Taylor-Gooby, 2001, 2004). As political differences narrowed during this timeframe, the influence that political party differences had on social spending became less significant. The result was widespread political support for the liberalization of the British welfare state.

Pre-Crisis Political Support for Liberalization

During the 1990s and 2000s, there was a considerable convergence of the policy positions of political parties on the left and the right in support of neoliberal reforms in the UK (Taylor-Gooby, 2001, 2004). Growing support for neoliberal policies played a strong role in British social policy debates and led to an effective political consensus. After a major and somewhat unexpected electoral defeat in 1992, many members of the UK Labour Party began to see their historical commitments to a large public sector, high tax rates, and generous social policies viewing as no longer financially sustainable or electorally viable (Taylor-Gooby, 2001). By the 1997 general
election, the Labour Party’s social policy approach was far more in line with the Conservative Party’s position that social policies must support economic competitiveness rather than promote social equality. This new neoliberal position was prominent in the Labour Party’s 1994 Commission on Social Justice report as well as its 1997 general election manifesto (Labour Party, 1994, 1997).

New Labour, largely under the leadership of Tony Blair, became strong advocates of ‘Third Way’ policies which emphasized social investment strategies as a way to reconcile welfare with a liberal market approach. ‘Third Way’ advocates (including Bill Clinton in the United States) argued that social and economic policies can be mutually reinforcing and that policies, such as workforce activation programs, could encourage increased productivity and economic growth (Hemerijck, 2013). In short, New Labour wanted to transform the welfare state from a passive benefit provider toward an active labor market promoter. From this perspective, social welfare was best achieved not through direct government expenditures, but rather by activating individuals and communities through policies, such as workforce development and job placement programs. This social investment approach would then be coupled with careful means-tested social spending towards targeted groups and justified by individual contributions to economic competitiveness (DSS, 1998).

Once in office, beginning in 1997, New Labour pursued many of the policy strategies of the previous Conservative led government, including fiscal restraint, welfare retrenchment, and the introduction of market-based social policies, including the partial privatization of the pension system (Hodson and Mabbett, 2009; Taylor-Gooby, 2001). Under the leadership of New Labour, the UK welfare state was largely reoriented to replace passive welfare benefits with workforce activation (Häusermann and Palier, 2008). As a result, political differences between the left-
leaning Labour and right-leaning Conservative parties were fairly minor throughout Blair’s ten years as prime minister. While disagreements persisted over issues, such as minimum wage and the extent of means tested government interventions, in many respects these differences were a matter of degree rather than fundamental ideological differences (Taylor-Gooby, 2001).

Overall, during the 1990s and 2000s there was a significant shift in the UK toward welfare state retrenchment and the introduction of liberal policies into the social sphere (Hemerijck et al., 2009). Political parties on the left and the right began to pursue policies which emphasized the importance of market-based welfare strategies which encouraged workforce participation, skill development, and competition while disavowing the passive social policies of the past (Lee and McBride, 2007; Swank, 2002). Due to the convergence of social policy positions of liberal and conservative parties, at this time, debates over social spending became less contentious (Stoesz, 1996, 2002; Swank, 2002; Taylor-Gooby, 2001). In many respects, the widespread acceptance of neoliberal policies across parties goes a long way to explain the lack of statistical significance that political party variables had on social spending during this period.

UK Welfare State Post-crisis

*Crisis Management Stimulus Measures (2008-2010)*

While the policy positions of political parties on the left and right in the pre-crisis period encouraged less state involvement in the social arena, the severity of the global economic crisis necessitated significant government intervention to stabilize domestic markets and minimize the social costs for citizens. The UK is a major global economic actor and was severely affected by the global financial collapse (Chung and Thewissen, 2011; Hodson and Mabbett, 2009). By the end of 2006, of the top 30 largest global banks, four were located in the UK accounting for 12%
of the total stock market value of the group (Laeven and Valencia, 2010). The UK economy, therefore, represented one of the largest international banking sectors in the world at the start of the crisis, second only to the US (Laeven and Valencia, 2010). As a result of their dominance of international finance, the bank failures that came with the global financial crisis were particularly dramatic for the British economy. Overall, between 2006 and 2009, the top 30 banks lost over 52% of their stock market value, representing a significant economic shock (Laeven and Valencia, 2010). The collapse of international financial markets and banking sectors resulted in a sharp drop in domestic GDP, rising unemployment, and reduced demand for goods and services in the UK.

In response to this rapid economic downturn, the UK government adopted considerable social spending increases in the form of stimulus measures.

It is important to note that, while this sudden government intervention and fiscal spending increase was in many ways in contrast to earlier pre-crisis spending patterns, the types of policies adopted were very much in line with liberal welfare state expectations. For example, although the British government took a more active role in supporting financial and banking sectors, providing a bailout package of £500 billion ($785 billion) to ensure liquidity, granting government guarantees of bank debts, and purchasing toxic assets, it adopted a far more hands off approach to social welfare policies after the crisis (Chung and Thewissen, 2011). In other words, the UK government’s crisis management response was characterized by a market-based strategy to address social issues and limited government intervention. In fact, despite already low levels of spending on unemployment support, the UK government was largely unwilling to increase funding even temporarily on these measures (Clegg, 2010, 5).

Rather than relying primarily on passive social spending to address growing unemployment in the immediate wake of the crisis, the UK government instead pursued demand-led labor market
policies to promote workforce activation. Around 10.5 percent of the total UK stimulus spending was dedicated towards active labor market measures aimed at encouraging workforce participation (ILO, 2011). In contrast to states, like Germany, which relied on a corporatist strategy of active state intervention in the labor market and direct negotiations with firms and employee associations, the UK relied more on market based strategies to address unemployment, such as offering subsidies for firms to hire employees (Chung and Thewissen, 2011). Beginning in January 2009, for example, employers received a subsidy of £2,500 ($3,900) for the hiring of any person who was unemployed for more than six months (HM Treasury, 2009). In 2009, the government also allocated over £3 billion ($4.72 billion) to fund programs designed to get the unemployed back to work, including job search initiatives and workforce training programs (Chung and Thewissen, 2011; EIRO, 2009f; HM Government, 2009).

Although the stimulus measures primarily focused on active labor market policies, some small increases were also made to passive welfare programs, including a slight increase in the maximum unemployment benefits for middle and high income earners (HM Treasury, 2009, 13). A small temporary bonus for pensioners and for families with children was also introduced at this time (Chung and Thewissen, 2011). However, despite these low levels of targeted spending increases, the social policy response of the UK to the crisis can largely be characterized as a liberal one. Crisis management responses relied on market forces to address social concerns and involved limited government intervention. While the focus of some national policies, like those of Germany, was to guarantee high levels of employment protection, the UK pursued a liberal policy strategy that provided incentives, such as corporate tax breaks, for firms to hire workers. In sum, the early crisis responses of the UK government, which relied on market-based policies and limited targeted
social interventions, seem to affirm the continued importance of welfare system institutional legacies in shaping social policy outcomes.

In keeping with the lower levels of social spending associated with liberal welfare systems, UK stimulus measures were less generous than many of the packages adopted by other European counterparts. While marking a shift toward expansionary social spending, the stimulus measures adopted by the UK between 2008 and 2010 were equivalent to a mere 1.4 percent of GDP, far lower than many other OECD countries (ILO, 2011; OECD, 2009). The duration of stimulus spending was also considerably shorter in the UK than in other countries. Whereas some states, such as the US, continued stimulus spending, beginning in 2010 there was a considerable drop-off in fiscal spending in the UK and the introduction of significant government spending cuts (Economist, 2013; ILO, 2011; OECD, 2009).

On the one hand, the policies adopted by the UK government in the immediate aftermath of the economic crisis represented an important change from the pre-crisis period. The initial response to the crisis marked greater government intervention and social spending increases than was seen in the previous two decades. On the other hand, British stimulus measures still largely reflected a liberal approach to social and economic policymaking, favoring market-based policies to restore growth, reduce unemployment, and protect vulnerable citizens. This liberal crisis response strategy is evident in the size, timing, and content of the stimulus package.

In addition to the social spending measures adopted by the government, automatic stabilizers provided an important source of social protection. According to research conducted by Dolls et al., automatic stabilizers in the UK absorbed 35% of the income shock, just below the EU average of 38% (Dolls et al., 2012). Automatic stabilizers also absorbed 42% of the unemployment shock in Britain, compared with an EU average of 47% (Dolls et al., 2012). These automatic stabilizers
played an important role in providing an immediate buffer to the economic crisis. Although the income and unemployment shock absorption of these automatic stabilizers was below the EU average, which is characteristic of the lower levels of social protection provided by liberal welfare systems, the response was far stronger than in Southern and Eastern Europe, reflecting the maturity and wealth of the British welfare system (Dolls et al., 2012).

Whereas the lack of a strong automatic stabilizer response has led in many cases to increased political divisions over discretionary social spending in Southern and Eastern Europe, such political contestation over social policies has not been nearly as pronounced in the UK. This is largely due to the centralized government system in the UK where the majority party has considerable influence over legislation. In other words, in addition to strong automatic stabilizer responses which reduced the need for politically contentious social sending decisions, the UK government structure also limited the conflict over policymaking. However, although the UK has not witnessed the same degree of political volatility seen in peripheral European states, there was important political turnover in the wake of the crisis as the ruling Labour Party was voted out of office in the 2010 national elections in favor of the Conservative Party. Whereas the Labour Party pursued an immediate crisis response strategy which encouraged increased social spending and government intervention, the electoral victory of the Conservatives marked a clear shift in government policies in favor of fiscal discipline and welfare state retrenchment. Throughout this new phase of crisis management the scope and scale of welfare cuts have grown significantly.

**Politics, Fiscal Discipline, and Austerity (2010 – Present)**

The victory of the Conservative Party in the 2010 UK national election led to a reversal of stimulus measures and the adoption of a legislative path toward fiscal discipline and austerity. In
his run up to the election, David Cameron, leader of the Conservative party, ran on a campaign platform emphasizing the need to cut government expenditures in order to address growing debt problems and restore economic confidence. A major focus of the Conservative legislative agenda has been to introduce some of the most significant cuts to the British welfare system since the end of World War II (New York Times, 2010a). Accounting for nearly one third of Britain’s annual budget, the Cameron government aimed to reduce welfare expenditures by about $30 billion from 2010 to 2014, representing around 10 percent of government outlays (New York Times, 2010a). In October 2010, Chancellor of the Exchequer George Osborne unveiled a series of major cuts, including a £7 billion (US$11 billion) reduction in welfare spending (Gardiner et al., 2010). This was in addition to £11 billion (US$17 billion) in welfare cuts that were outlined in an emergency budget earlier that June as part of a social reform package (Gardiner et al., 2010). This welfare state retrenchment was part of larger public spending reductions to cut £81 billion (US$130 billion) from public spending, reduce public sector jobs by 490,000, and eliminate the structural budget deficit by 2015 (Gardiner et al., 2010).

Indicating his perspective on how best to manage the crisis, Prime Minister Cameron in a speech to world leaders at the 2011 World Economic Forum meeting in Davos Switzerland stated that, “Those who argue that dealing with our deficit and promoting growth are somehow alternatives are wrong. You cannot put off the first in order to promote the second” (Cameron, 2011). The Cameron administration, therefore, has dismissed arguments that more government spending is needed to fight the crisis. Rather the Conservative government has continued its insistence on the need for fiscal reductions to address rising public debt, ensure good credit ratings, and lower borrowing costs which would help facilitate a private sector-led recovery (Economist, 2010a; EUCE, 2013). The government has also pursued an agenda of “compassionate
conservatism” and a “Big Society” approach emphasizing the role that individuals, communities, and volunteer groups, rather than government, should play in providing social support (BBC, 2010; Cameron, 2010). This reflects the Conservative party’s position that government intervention should be limited and that social welfare should be driven by the private sector.

As a long-term strategy to address the economic crisis and restore growth and stability, the Conservative UK government has taken a pro-austerity position which has made the British welfare state a target of drastic spending cuts. These social spending reductions, which began with the 2010 electoral success of the Conservatives, have continued to the present, as Prime Minister Cameron has outlined future welfare cuts after winning the most recent 2015 national election. With its return to power, the Conservative Party is moving forward with its plan to impose £12 billion (US$19 billion) in further cuts to the British welfare budget by 2018 (Guardian 2015a; 2015b). These policies will include a reduction in the household welfare benefit cap from £26,000 (US$41,000) to £23,000 (US$36,000) (Guardian, 2015b; Mirror, 2015b). To achieve this social spending reduction goal, the Conservative Party will need to significantly increase the pace of welfare cuts, indicating further social benefit decreases overtime, rather than a slowdown of retrenchment policies (Guardian, 2015b).

The Crisis and Growing Political Divisions

While post-crisis social spending policies in the UK have largely been defined by the ruling Conservative party, the political consensus, which was widespread during the pre-crisis period, has fragmented in the wake of the global recession as political parties of the left and right have engaged in larger debates over the role of the welfare state in facilitating effective social and economic recovery. Although supportive of long-term fiscal discipline and liberal social
investment strategies, the Labour Party has been critical of the Conservative crisis management response. Representing a degree of political opportunism, the Labour Party has blamed Conservative Party policies for the slowest economic recovery in over a hundred years, a failure to address the deficit, and planning cuts which would return public spending in Britain to 1930s levels (Labour, 2015a). The Labour Party, along with other opposition parties, such as the Liberal Democrats and Green Party, have been critical of Tory plans to enact £12 billion (US$19 billion) in welfare cuts arguing that these reductions would have a considerably negative impact on the average citizen. These parties have also criticized the lack of transparency over how these cuts would be implemented. Ed Milliband, then head of the Labour Party, as well as leaders from the Liberal Democrats, independently attacked the ‘secretive’ nature of proposed Conservative welfare cuts, arguing that they will have a significant harmful impact on welfare recipients, such as those receiving child benefits (Financial Times, 2015; Spectator, 2015).

As the leading opposition party, Labour leaders have argued that the Conservative Party has been far more interested in cutting welfare than reforming it to facilitate greater workforce participation (Labour, 2015b). As a result, the proposed budget, put forth by the Tories, may be at risk as the Labour Party has opposed over half of the welfare cuts outlined in the plan (Guardian, 2014b). This increased conflict over government crisis management strategies, is indicative of the fact that since the start of the crisis, political differences have grown between parties on a range of social policy positions. In the case of welfare spending, whereas the Conservative Party has called for massive cuts in working-age benefits, the Labour Party, by contrast, has made no plans to reduce existing benefit levels (Independent, 2015b). The Liberal Democrats have proposed plans to increase working-age benefits by one percent (Independent, 2015b). The Greens have gone even further to suggest the current benefit system should be scrapped and replaced with a more
comprehensive and generous guaranteed basic income for all citizens (Independent, 2015b). Labour has proposed a rise in the minimum wage to £8 (US$12) an hour by 2019 and a reduction in university tuition fees from £9,000 (US$ 13,845) to £6,000 (US$ 9,230) (Independent, 2015b). The Greens have also been in favor of a minimum wage increase to £10 (US$ 15) an hour by 2020 and a green investment program, which they argue will create over a million new jobs (Independent, 2015b).

Along with creating larger divides between the political positions of parties on the center-left and center-right, the ongoing economic crisis has led to the rise of the anti-EU UK Independence Party (UKIP). As the effects of the economic crisis have persisted, UKIP has been able to leverage public disillusionment with the EU and mainstream political parties to achieve greater electoral success. In the most recent 2015 UK national elections, UKIP received a 12.6% share of the vote representing a 9.5% increase since the 2010 national elections (BBC, 2015d). The party has advocated for the exit of Britain from the EU and call for more protectionist policies. While not overtly anti-immigrant, UKIP advocates for stricter policies on immigrants, including greater limitations on access to social welfare services. UKIP, for example, pledged to restrict benefits for migrants to only those who have been paying taxes and national insurance for past five years (Telegraph, 2015). Similarly, UKIP wants to limit child benefits to permanent residents (Telegraph, 2015). In line with it more conservative approach to the issue of immigration, the party is also in favor of domestic liberalization and privatization of healthcare services. In particular, UKIP has argued in favor of privatizing key health services, such as hospitals and surgeries (Guardian, 2013b). It has also proposed creating a voucher system that would allow citizens to opt out of the National Health System all together (Guardian, 2013b).
In addition to its national success, UKIP won a decisive victory in the 2014 elections for the European Parliament receiving 26.8% of the vote (European Parliament, 2014). Not only did this represent an incredible 10.7% increase from its results in the 2009 European Parliamentary elections, but UKIP was able to beat out both mainstream political parties the center-left Labour Party and the center-right Conservatives (European Parliament, 2014). UKIP’s success rests on a growing anti-EU populist movement that has gained momentum since the start of the economic crisis as more and more voters have become disheartened with traditional political parties and the broader European project. This indicates increasing polarization within the UK political system since the start of the global economic crisis. The crisis, in other words, was the main catalyst for these movements which are having a profound effect on domestic and EU policies and politics.

Overall, these varied positions indicate that since the start of the crisis political tensions have increased and a gap has grown between political parties over social and economic policies. As such, the effect of conservative party presence on social spending levels has become statistically significant resulting in reduced government expenditures across social spending areas. While divisions have grown between parties over social spending and questions of fiscal austerity, there has not the same degree of political volatility as seen in some Southern and Eastern European states. Strong automatic stabilizers and government responses in the early stages of the crisis, which helped to minimize the negative social and economic consequences of the recession, are were largely responsible for limiting this political polarization. However, as the crisis has worn on political party control of government has been a key factor shaping the national social policy agenda. The electoral success of the Conservative Party in 2010 resulted in a turn away from stimulus measures and a clear embrace of austerity policies, which emphasize fiscal discipline and welfare state retrenchment.
Conclusion

While political party differences were far less significant in shaping social spending levels prior to the economic crisis, as there was strong support across parties in favor of welfare liberalization, the severe nature of the global financial market collapse generated a clear shift in government policies and domestic politics. As an immediate response to the recession, the ruling Labour government adopted crisis management policies that increased public spending on areas such as unemployment and workforce activation, and greater overall state involvement in the social sphere. These reactive stimulus measures represented an important break from pre-crisis policy approaches emphasizing the need for reduced social spending and limited government intervention into the marketplace. The electoral success of the Conservative Party in 2010, not only indicated a return to limited government spending on social benefits, but marked the beginning of considerable welfare state retrenchment and far reaching cuts across social policy areas. As with the case of other conservative led governments, such as Germany, center-right party control in the UK has led to significant cutbacks to welfare state spending (EUCE, 2013).

In addition to the effects on domestic social spending, Conservative Party control of the British government has had important implications at the European level. Along with German Chancellor Angela Merkel, British Prime Minister David Cameron has been a leading voice calling for austerity and fiscal discipline as the best strategies to address the Eurozone crisis. Representing a clear contrast between conservative and liberal parties, over how to handle the economic crisis, in 2010 US President Barack Obama wrote to Prime Minister Cameron and other EU leaders warning that premature cuts in government spending and social welfare support could create further economic instability and potentially lead to a double-dip global recession (New York Times, 2010b). Indicating his contrasting perspective, Prime Minister Cameron in a speech to world
leaders at the 2011 World Economic Forum meeting in Davos Switzerland stated that, ‘Those who argue that dealing with our deficit and promoting growth are somehow alternatives are wrong. You cannot put off the first in order to promote the second’ (Cameron, 2011). The Cameron administration therefore has dismissed claims that increased social spending is needed to fight the economic crisis in Europe and has continued its insistence on austerity measures and fiscal reductions (Economist, 2010a; EUCE, 2013).

The ability to shape the European crisis management response strategies, on the one hand, highlights the considerable power that wealthy creditor countries, such as Germany and the UK, have been able to exercise at the EU level. On the other hand, the UK and its conservative allies, including Germany and Finland, have been under increasing pressure by EU leaders to end the strict austerity approach to resolving the crisis (Independent, 2013). While Britain has not faced political volatility at home, it has seen tensions increase throughout Europe as popular discontent has grown over austerity measures, particularly in debtor states in Southern Europe (Independent, 2013). In many respects, this has led to increased political and economic instability at the European level and hurt domestic growth within the UK.

In sum, since the start of the global economic crisis, political party differences have been a key factor shaping the long-term crisis management social spending strategies adopted by the UK government. Unlike in other states, with federal systems that allow greater influence for opposition parties, due to the centralized nature of the British political system the Conservative Party’s influence over national policies since 2010 has been considerable. Conservative Party leadership has not only set the course of domestic policies in favor of fiscal discipline and austerity, but has influenced the position that the UK has taken up within larger European debates on how to address the crisis throughout the region. The UK case, therefore, provides compelling evidence for the
effect that conservative party control of government has had on long-term social spending outcomes in the aftermath of the global economic crisis.
Chapter 7: Sweden

In many respects, Sweden is a quintessential example of the Nordic welfare system, which is based upon a social protection model in which the state provides high levels of universal benefits and services to all citizens (Esping-Andersen, 1990, 1999; Häusermann and Palier, 2008; Kvist 1999; Pierson, 1996, 2001). The principle of universal social rights is a cornerstone of the Swedish welfare state in which benefits are extended to the entire population, rather than social services being targeted solely toward the vulnerable lower class, as in Liberal welfare regimes. As a result, a much wider proportion of political constituents are beneficiaries of welfare state assistance than in many other countries. Due to the generous welfare benefits, Nordic states, such as Sweden, typically have lower levels of poverty, income disparity, and social exclusion than many of their European counterparts (Häusermann and Palier, 2008). Citizens in these states also face much higher tax burdens to fund these extensive and generous welfare arrangements.

This chapter will explore Sweden in the timeframe prior to the global economic crisis and in the aftermath of the recession to see how this event has altered domestic social spending patterns and reshaped the political dynamics operating within the country. The chapter will start by exploring social spending in Sweden during the two decades prior the crisis, which was notable for a surprising liberalization of welfare policies. Policies which gained acceptance across political lines. The second section will examine the immediate stimulus package put forth by the Swedish government in response to the global economic collapse. In particular, this section will identify how reactive stimulus spending was shaped by historical welfare arrangements. These initial stimulus measures represented an important break from pre-crisis liberalization policies. Finally, I will investigate the increasingly vital role that politics has played in defining long-term post-crisis social spending in Sweden. Remarkably, despite the generous and universal nature of the
traditional Swedish welfare system, I argue that conservative party control of government has created pressure for social spending decreases and continued welfare liberalization. While this does not indicate a convergence of the Swedish model toward a liberal welfare system, it does speak to the powerful influence that political parties play in shaping social spending outcomes even within one of the most universal and generous welfare states in Europe.

**Swedish Welfare State Pre-crisis**

**Social Policy Liberalization**

In the two decades preceding the global economic crisis, the Swedish government undertook a series of welfare reforms which included efforts to liberalize, privatize, and shrink the social protection system. In many respects this move toward welfare state liberalization and social spending consolidation was triggered by a considerable financial crisis that Sweden faced in the early 1990s (Haffert and Mehrtens, 2015). Beginning in 1991, the Swedish economy was significantly affected by a major crisis stemming from failures in its banking sector (European Commission, 2009b). Policies of financial liberalization and capital market deregulation adopted in the mid-1980s in Sweden had effectively removed quantitative restrictions on the volume of bank lending. As a result, the Swedish banking sector saw a credit boom starting in 1985 and large investments in housing, commercial real estate, and the stock market (European Commission, 2009b). This led to asset overvaluation and the eventual collapse of the housing market in 1991, creating widespread liquidity problems in the banking sector remarkably similar to those that led to 2008 subprime mortgage collapse in the United States. These banking failures had broader consequences for the Swedish economy, leading to a massive increase in unemployment, a sharp decline in tax revenues, and higher public expenditures, due to a large automatic stabilizer
response. As a result of this banking crisis, the annual deficit of the Swedish government soared nearly doubling from approximately 45 percent of GDP in 1990 to over 80 percent in 1994 (Englund, 1999). This led to public debt problems as debt to GDP increased significantly. Overall, the crisis of the 1990s in Sweden was one of the worst economic downturns in its history. In fact, not only was the economic growth severely weakened, but the cumulative employment loss was even greater than during the Great Depression of the 1930s (European Commission, 2009b).

In the wake of the crisis the Swedish political leaders faced enormous pressure to pursue far-reaching fiscal consolidation and drastic expenditure cuts (Englund, 1999). By mid-1995, austerity measures equivalent to 8 percent of GDP had been adopted representing considerable fiscal reductions (Haffert and Mehrtens, 2015). The crisis management response adopted by the Swedish government during this time was notable for a high degree of political unity. Political leaders from within the center-right government coalition and the center-left Social Democratic opposition party accepted prevailing liberal economic beliefs that extensive welfare reforms and a restructuring of public finances was needed to bring the crisis under control (European Commission 2009b; Haffert and Mehrtens, 2015).

The logic of fiscal consolidation and the necessity of liberal reforms which grew out of these crisis management policies, led to more sweeping reforms to social policies within Sweden throughout the 1990s and 2000s. As in the case of fiscal consolidation measures in the aftermath of the banking crisis, liberal welfare reforms during the 1990s and 2000s received widespread political support from both center-left and center-right parties (Bergh and Erlingsson, 2009). While political differences remained between Swedish political parties, leading to an electoral defeat of the center-right ruling coalition by Social Democrats in 1994, the liberal reforms introduced by conservatives were not reversed by the new center-left government and in fact were continued in
many respects. This reflects the overwhelming support that liberal policies received across parties during the 1990s and 2000s.

One of the most significant liberal reforms that the Swedish government undertook was the 1990 tax reform. This change has often been referred to as the “tax reform of the century” since it was the most extensive transformation of tax policies that any advanced industrialized state had undertaken since the end of World War II (Haffert and Mehrtens, 2015). Introduced by the center-right government, changes to the tax code effectively reduced public revenue streams by lowering income and corporate tax rates. These liberal policy changes were intended to stimulate economic growth by encouraging higher levels of foreign investment and encouraging a business friendly environment. For example, under the new legislation, the corporate tax rate, which had been at 57 percent was reduced to 30 percent (Auerbach et al., 1995). However, these liberal reforms had profound implications for the Swedish welfare system since tax policies had been predicated on the notion that progressive taxation was an efficient way to transfer resources from the wealthy to the poor (Agell et al., 1996). Since the Swedish welfare system is reliant on direct taxation as a source of funding, rather than workforce contributions as in the case of Continental European welfare regimes, this reduction in revenue constrained the level of social spending that the state could adopt.

Since the reform was introduced in 1990, Swedish tax policy has continued in a similar manner with liberal reforms accepted across parties. For example, in 2004 the Social Democratic led government abolished the inheritance tax after reducing it several times before (Haffert and Mehrtens, 2015). After taking office in 2006, the center-right government reduced tax rates further and even went so far as to eliminate some taxes all together, for example wealth and property taxes (Haffert and Mehrtens, 2015). In 2014, the conservative government once again announced that it
would cut income taxes, the fifth time it had done so since coming into office (Haffert and Mehrtens, 2015).

A second major reform that the Swedish government adopted was to the pension system. The pension reform of 1994-1998 made the system independent from the national budget, so that public funds would no longer cross-subsidize pensions; only revenues raised by the pension system itself would be distributed, and if contributions declined benefits would be adjusted downward accordingly (Haffert and Mehrtens, 2015). The goal of the reform was to reduce government expenditures and encourage a Swedish investment culture in private pensions (Belfrage and Ryner, 2009). Since the reforms have been enacted, nearly 90 percent of Swedes have felt the need to invest in private insurance in addition to their public pensions (Edlund, 2006).

In addition to large sweeping changes to the tax and pension systems, Sweden also made significant reductions to its public employment sector beginning in the 1990s. Between 1990 and 1998 the number of people employed in the public sector in Sweden declined by over 200,000 individuals (Haffert and Mehrtens, 2015). As in the case of pension reform, the ostensible goal of public sector employment reductions was to limit government expenditures and emphasize greater reliance on the private sector. These liberal reforms were embraced not only by parties on the right, but also by progressive leaders such as Göran Persson who served as Swedish Prime Minister from 1996 until 2006 and was the head of the Social Democratic Party (Haffert and Mehrtens, 2015). In many respects, the prevailing liberal belief that fiscal consolidation and social investment strategies, which focused on competition, would lead to higher economic growth, was largely uncontested at the time. This resulted in left-leaning parties, traditionally in favor of a strong well-funded welfare state, to justify a certain degree of retrenchment as a way to improve efficiency and social policy sustainability. It is important to note, however, that while considerable liberal
reforms were introduced to the Swedish welfare system prior to the global economic crisis, that this did not entail a convergence toward a liberal welfare system. In fact, although Sweden had implemented a number of cutbacks to its welfare system, the state still maintained higher levels of social protection and a larger public sector than many of its European counterparts (Vis, 2009).

**Swedish Welfare State Post-crisis**

*Crisis Management Stimulus Measures (2008-2010)*

Whereas social policy liberalization had become widespread in Sweden during the 1990s and 2000s, the severity of the global financial crisis required immediate and substantial government intervention to stabilize domestic markets and minimize the social costs for citizens. In many respects, the crisis management response of the Swedish government in the aftermath of the global recession was in line with more traditional Nordic welfare strategies, predicated on generous social spending and greater state involvement in the social arena. This hints at the influential role that Swedish welfare institutions played in defining the government’s social and economic policy response in the period immediately following the crisis. In other words, while the economic crisis triggered the Swedish government to intervene in the form of an extensive stimulus package, the makeup of these measures were largely in line with spending patterns expected based upon the social protection systems within the country, rather than the adoption of liberal market-based crisis management strategies, such as those adopted in states like the UK.

In the immediate aftermath of the crisis, the Swedish government passed a stimulus package worth SEK 15.5 billion (US$1.8 billion) (US Federal Government, 2009). The government also adopted subsequent crisis policies worth SEK 45 billion (US$5.21 billion) in 2009 and SEK 60 billion (US$6.95 billion) in 2010 (Swedish Ministry of Finance, 2009a).
Reflecting the generosity of the Swedish welfare system, the size and scope of these stimulus measures was much larger than that of many other European countries (Chung and Thewissen, 2011). In composition, the stimulus package reflected traditional Nordic welfare strategies and goals placing a strong emphasis on income protection and workforce activation by expanding already generous and universal social programs. One of the major goals of the stimulus measures was to promote full employment, while also providing income protection and unemployment benefits for citizens (Swedish Prime Minister’s Office, 2008).

In order to provide greater protection against the effects of rising unemployment, the Swedish government relaxed requirements for unemployment benefits and abolished work history eligibility requirements (EIRO, 2008; Swedish Ministry of Finance, 2008). Increased public funding was provided to expand welfare programs at the municipal level, including a SEK 5 billion increase per year (US$580 million) and a supplementary SEK 7 billion (US$810 million) in 2010 (Swedish Ministry of Finance, 2008). A number of changes in tax benefits were also introduced to provide greater income security, including a lowering of in-work tax credits, an increase in income tax deductions, and a lower state income tax. In sum, these measures provided a tax reduction of over SEK 1,000 per month (US$115) for 97 percent of full-time workers (Swedish Ministry of Finance, 2008). Taxes on marginal income-based pensions were also lowered providing more income to 90 percent of Sweden’s pensioners (Swedish Ministry of Finance, 2008).

The Swedish government also invested in a number of workforce activation policies intended to facilitate higher rates of employment. As part of this social benefit program, the Swedish stimulus package provided funding for a number of job training and vocational workshops with the goal of training 165,000 individuals by 2011 (Economy Watch, 2010). To promote education and skill development the study allowance grant for individuals over 25 was increased
to 80 percent of the total cost and additional public funds were dedicated to a range of employment programs (EIRO, 2009g). The Lyft program created 40,000 temporary jobs within the public sector, providing employment opportunities and skill development for those out of work (EIRO, 2009h; Swedish Ministry of Finance, 2009b). To increase employment incentives, the government lowered the payroll tax for employers and reduced the level of unemployment contributions required by employees (EIRO, 2008). These reductions were even higher for the youth workforce who faced higher rates of unemployment than other demographic groups after the crisis (EIRO, 2008; Swedish Ministry of Finance, 2008). Finally, to encourage companies to hire the long-term unemployed, the government cut employment tax requirements in half (Chung and Thewissen, 2011).

Overall from a welfare perspective, the Swedish stimulus package was characterized by an expansion of universal social benefits and greater investment in workforce activation policies (Chung and Thewissen, 2011). It is important to note, however, that these strategies to address unemployment differed in important ways from other welfare systems. Whereas Germany, as an example of a Continental welfare regime, intervened directly in the labor market, the Swedish government did not do so, relying instead on negotiations between social partners to come up with tenable solutions to rising unemployment (Chung and Thewissen, 2011). While liberal states, such as the UK, adopted a largely hands of approach to social policy in the aftermath of the crisis, the Swedish government was directly involved in providing high levels of social protection. For example, although the UK relied primarily on market-based tax incentives to encourage employers to hire more workers and was less willing to increase spending on unemployment policies, Sweden combined workforce activation with a generous increase in unemployment and other social welfare policies and (Chung and Thewissen, 2011; Clegg, 2010). The crisis management response adopted
by the Swedish government emphasizes the important ways in which institutional welfare legacies shaped the reactive policy choices and decisions of states at the start of the crisis. In other words, while Swedish welfare policies in the decades building up to the crisis included a series of liberal reforms, in the wake of the global financial crisis, government policies marked a return to expansionary fiscal policies and broad increases in social spending emblematic of Nordic welfare state strategies.

In addition to the social spending stimulus measures adopted by the Swedish government in response to the economic crisis, automatic stabilizers provided a high degree of social protection for citizens. In the wake of the global recession, automatic stabilizers within the Swedish welfare state absorbed 42% of the income shock, well above the EU average of 38% (Dolls et al., 2012). Automatic stabilizers acted as an even stronger buffer against the negative effects of the crisis on the Swedish labor market, absorbing a remarkable 68% of the unemployment shock, over 20 points higher than the EU average of 47% (Dolls et al., 2012). The strength of these automatic stabilizing mechanisms speak to both the scale and scope of the Swedish welfare system. These generous social transfers, in combination with stimulus measures, played a key role in stabilizing disposable incomes and household demand within the Swedish economy.

**Politics, Fiscal Discipline, and Austerity (2010 – Present)**

In many respects the combination of generous stimulus measures and a strong automatic stabilizer response provided significant protection for Swedish citizens against the effects of the economic crisis. The result has been to limit social unrest and provide a higher level of political stability than can be seen in many harder hit peripheral European countries. However, although Sweden has not seen the same degree of political upheaval as in some other EU member states,
political party control of government has played an extremely important role in driving post-crisis social policy outcomes. Unlike many ruling parties, which were unseated in the wake of the financial crisis, the conservative Moderate Party, which won electoral victory in 2006 on a platform emphasizing increased tax cuts, job creation, and welfare reform, was able to remain in power after the 2010 national election. This was fairly remarkable for a party that introduced considerable reductions to the welfare state and privatized a number of state-owned companies, including in the education and health care sectors (Huffington Post, 2014a).

Since coming to power in 2006, Swedish Prime Minister Fredrik Reinfeldt's center-right coalition accelerated the pace of liberal welfare reforms begun in the 1990s. The major economic policy focus of the conservative government has been to reduce income, wealth, and corporate taxes as a way to promote competition and job growth, focusing on supply-side economics rather than government interventionist strategies (Spectator, 2012). Reducing the tax base also meant reducing the size of the welfare state. To this end the conservative led government tightened benefit eligibility criteria for unemployment benefits and sick pay (The Local, 2014). Public spending as a percent of GDP declined nearly 20 percent from a record high of 71.0 percent in 1993 to 53.3 percent in 2013 (The Local, 2014). To put these reforms in perspective, of all of the Scandinavian countries, Sweden has gone the furthest in reducing the size of its welfare state (The Local, 2014).

In many respects, the crisis management policies of the center-right coalition have translated into economic success. In contrast to many other European states, Sweden has seen GDP growth of 12.6 percent, an increase in disposable household income, as a result of further tax cuts, and a large budget surplus (Huffington Post, 2014a). However, while economic growth and public spending have improved in Sweden since the start of the crisis, social conditions have worsened in terms of poverty and social equality. Between 2007 and 2010, income inequality in Sweden rose
considerably (by 1.0 percentage points measured by the Gini index), an increase that was only exceeded by Spain (3.0 points) and the Slovak Republic (1.7 points) (Dølvik et al., 2014). The poverty rate in Sweden also increased from 7.4 percent of the population in 2007 to 9 percent in 2010 (OECD, 2015b). To put this in perspective in 2010 the poverty rate was 8 percent of the population in Germany and 10 percent in the UK. Yet, it is important to note that, despite increasing social inequality, in 2010 Sweden was one of the few OECD countries in which the richest 1 percent of the population had the lowest share of pre-tax income, around 7-8 percent, compared with 13 percent in the UK and Germany (OECD, 2014c). This indicates that while social conditions had gotten worse since the start of the crisis, they were still far more favorable than in many other welfare systems.

Rising social inequality, however, has led to concerns among center-left opposition parties that pro-market reforms have undermined the country’s welfare system and the long-term well-being of Swedish citizens (Huffington Post 2014a). For example, the unemployment rate has risen to around 8 percent, the highest of any Nordic state, and the youth unemployment rate has increased to over 19 percent (Bloomberg, 2014a; Policy Network, 2013). Since 2010, the Swedish economy has also begun to slow with an average of only 1.5 percent GDP growth during this time (OECD, 2015b). This has led to greater criticism of center-right policies which have cut taxes and reduced social welfare benefits. Although the Swedish economy has been one of the most resilient in Europe in the aftermath of the crisis, new challenges to maintain economic growth, reduce unemployment, and ensure the well-being and prosperity of citizens have led to increased political conflict that was largely absent in the decades building up to the crisis.
The Crisis and Growing Political Divisions

Although generous social spending on behalf of the Swedish government provided a significant buffer for citizens against the economic downturn, thus limiting social unrest and political volatility, divisions have grown between political parties on the left and the right. These increased political divisions are in many respects the result of a growing ideological divide between those who continue to support liberal welfare reductions and fiscal discipline as the best long-term means to address the crisis, and those who have begun to question the orthodoxy of this strategy and instead favor continued government spending to bolster economic recovery. As a result of this increased politicization of the welfare state, political party control of government has played a critical role in shaping national social spending outcomes.

Despite the need for immediate fiscal stimulus in the wake of the financial crisis, in many respects the global economic collapse reinforced the conservative Swedish government’s belief in the necessity of fiscal discipline and continued welfare state retrenchment. In an interview, Anders Borg, the conservative Swedish Finance Minister, said that he was determined that the 2008 economic crisis would not stop him from cutting the size of government (Spectator, 2012). To this end, Borg continued to cut taxes and reduce welfare spending as a way to stimulate growth. This even included unpopular measures to cut property taxes for the wealthy as a way to entice entrepreneurs and investors to come back to Sweden (Spectator, 2012). These liberal policies followed the logic that long-term economic recovery would be best achieved through market-led investments, rather than through government stimulus to increase demand and reduce unemployment. Corporate tax cuts it was argued would encourage greater business investment and job creation leading to higher economic growth and lower levels of unemployment. Income tax
cuts it was argued would increase the disposable household incomes leading to higher demand which would further fuel economic growth.

While the Swedish Social Democrats had been supporters of welfare state liberalization prior to the crisis, the position of the party shifted considerably since the start of the financial collapse. In the wake of the crisis, Social Democrats have been far more skeptical of the pro-market reforms advocated for by the conservative governing coalition. Rather than embracing liberal reforms, Social Democrats have argued that these policies have weakened the welfare state, leading to higher levels of poverty, unemployment and social inequality, while failing to generate more jobs or economic growth. Social Democratic party leader Stefan Löfven has criticized Prime Minister Reinfeldt's center-right government, arguing that after seven years in power conservative policies only led to high levels of social inequality and an unemployment rate that was higher at the end of their term than when they took office (Reuters, 2014b). In an interview prior to the 2014 Swedish national elections, Magdalena Andersson, the current Social Democratic Finance Minister, stated that, “the [conservative] government has done completely the wrong thing when they have pushed through big and ineffective and expensive tax cuts instead of making important investments in jobs and education” (Bloomberg, 2014b). This position reflects larger public concerns that tax cuts, social spending reductions, and privatization efforts pursued by the center-right government critically undermined the welfare system in the country.

The Social Democrats have also voiced opposition to center-right efforts to privatize national healthcare and education systems, echoing public concerns that such policies would weaken the social safety net. This issue became a prominent concern after a series of scandals in the Swedish media involving falling standards in schools, reports of overcrowding in hospitals, and mistreatment in elder care facilities (Huffington Post, 2014a; Wall Street Journal, 2014). Anxiety
also increased after the 2014 OECD Programme for International Student Assessment survey sent shock-waves through Sweden indicating that educational standards over the past decade had dropped from around average to significantly below average in math, reading comprehension, and natural sciences (OECD, 2014c). Sweden’s schools, once leaders in education, ranked below both the US and the UK (OECD, 2014c). Growing concerns over the effects of liberal policies on the Swedish welfare state highlight the increasing divide between parties on the left and right in the wake of the crisis and have signaled a larger political shift toward the left in the most recent national elections.

Despite remaining in power in the years immediately following the economic crisis, by 2014 the center-right coalition faced a major political challenge from the center-left Social Democrats. Social Democrats ran on a platform to reverse the tax cuts and welfare state reductions that the conservatives had enacted in recent years, pledging to increase the government’s revenue so that it can fund greater unemployment and sickness benefits, invest in education, and promote job creation with the objective of Sweden having the lowest unemployment rate in Europe by 2020 (Bloomberg, 2014b). To this end, since the national election in 2014, Swedish Social Democrats have pledged to reverse nearly one-third of the 130 billion kronor ($18.3 billion) tax cuts that the conservative government adopted and dedicate the increased revenue to education, public sector jobs and more generous unemployment and sick-leave benefits (Bloomberg, 2014a). In addition the Social Democrats have stated that they will further increase spending by 40 billion Swedish crowns (US$5.7 billion) on welfare programs, schools, and job creation (Reuters, 2014b). The Swedish Social Democrats platform of welfare state expansion is in stark contrast to the pre-crisis consensus on the necessity for limiting the size and scope of the welfare state and serves as a clear indicator of the ideological changes that have occurred in the aftermath of the crisis.
The 2014 electoral victory of the Swedish Social Democrats and the growing divide between center-left and center-right parties over issues of welfare reform and fiscal discipline has had important implications not only domestically, but at the European level. The presence of conservative party leadership in Sweden in the years following the crisis was critical in shaping European social and economic policymaking. While not fully embracing austerity as a cure-all for Europe’s woes, Reinfeldt and his conservative led government were still an important ally for countries like Germany and the UK that advocated for fiscal prudence and structural reforms (Huffington Post, 2014b). Reinfeldt was often a reliable partner for UK Prime Minister David Cameron and German Chancellor Angela Merkel in advocating for more pro-market EU policies to improve regional competitiveness (Wall Street Journal, 2014). Under center-right government leadership, Sweden surprisingly became a strong advocate of supply-side economics and more ideologically attuned to arguments favoring austerity and fiscal prudence. Former Swedish Finance Minister Anders Borg, for example, served as a high-profile champion of fiscal discipline in Europe arguing that in order to address its debt problems and facilitate the recovery of European markets, the EU needs to accept more financial austerity (Market Watch, 2013; Wall Street Journal, 2014). It is clear then that the conservative government in Sweden has shaped the position that the country has taken in European debates and contributed to the strength of the pro-austerity coalition, which includes countries such as Germany, the UK, and Finland.

The recent electoral victory of Sweden’s Social Democrats may signal an important shift for social and economic policies both in Sweden and at the European level. In fact, many question whether this shift may mark an end of European austerity policies and an embrace of a pro-growth agenda which focuses on relaxing fiscal and monetary policy requirements in order to stimulate economic growth. Mr. Löfven has campaigned for higher levels of EU investments to promote
growth in areas such as job creation and education, which would be funded with higher taxes on companies and the wealthy (Huffington Post, 2014b). Whereas his predecessor Mr. Reinfeldt worked closely with leaders in Germany and the UK, Mr. Löfven seems more likely to align with France's Francois Hollande and Italy's Matteo Renzi leaving the pro-austerity camp even more isolated (Economist, 2014a). In many respects, the electoral success of Sweden’s Social Democrats stands out as a rebuke to austerity at home and throughout Europe.

The economic crisis, therefore, has acted as a clear catalyst for political division and change in Sweden with important implications both within the country and across Europe. Signaling the increased level of politicization that has occurred since the start of the crisis, Sweden has not only seen a growing divide between the policy positions of center-left and center-right parties, but has also witnessed the rise of the far-right Sweden Democratic Party in national elections. While the 2014 national election saw the return of the Social Democrats to power, the results also represented a significant victory for the Sweden Democrats, an anti-immigration party with neo-Nazi roots, whose share of the vote rose to 13% from 5.7% in the 2010 elections, making them the third-largest party in Parliament (Wall Street Journal, 2014). This followed the electoral success that the party received in the 2014 European Parliament elections with the Swedish Democrats receiving 9.67% of the vote and earning two seats in the body (European Parliament, 2014). Sweden Democrats join a number of anti-EU far-left and far-right parties who gained seats in the 2014 European Parliament elections. As a party dedicated to nationalism, protectionism, social conservatism, and anti-immigration, the strong showing of Sweden Democrats in both national and EU elections signals an increased polarization of social and economic policies and an electoral push toward the political fringes since the start of the crisis.
Conclusion

Despite its long history favoring universal social programs and progressive taxation, Sweden began to adopt a series of liberal welfare reforms in the early 1990s in response to a serious financial crisis, which many at the time saw as a failure of the social democratic model. In response to this event many policymakers at the time emphasized the need for Sweden to adopt liberal social and economic reforms. Political party differences during this time were far less significant in shaping social spending levels as a growing consensus was established among parties in support of welfare liberalization efforts. Neoliberal ideology became more prominent among Social Democratic leaders, bringing them more into line with the views of center-right political parties (Bergh and Erlingsson, 2009). The two decades prior to the global recession in Sweden, therefore, represented a time of increased welfare liberalization and a narrowing political divide over social and economic policies. As a result, political conflict over social spending was more muted as parties on the center-left and center-right pursued similar policies (Bergh and Erlingsson, 2009; Haffert and Mehrten, 2015).

The severity of the global economic crisis, however, necessitated immediate government intervention and social spending increases in Sweden. These policies represented a break from the liberal policies and welfare reductions that had been introduced in the past two decades and reflected a more traditional Swedish welfare state approach. In addition to triggering increased social spending, the crisis led to greater political divisions and debates over the reintroduction of liberal policies as a solution to the crisis. Although the center-right governing coalition was able to maintain political power and continue its policies of tax cuts and welfare reductions to promote economic growth, they faced a growing challenge from center-left parties. Most notably the Social Democrats began to seriously question whether these liberal policies had gone too far in
undermining the social protection system. The increasing political gap that has occurred since the start of the crisis resulted in government turnover in Sweden with the 2014 electoral victory of the Social Democrats. This electoral outcome signaled a shift in national social and economic strategies toward greater social spending levels. The crisis can, therefore, be seen as a catalyst for renewed debate and division over the importance of the welfare state and the efficacy of pro-market reforms in promoting social and economic well-being in Sweden. The political changes which have occurred in Sweden, since the start of the crisis, may have important implications on the debate over austerity and growth domestically and throughout Europe as leaders struggle to find the most effective and politically viable long-term solutions to the crisis.
Chapter 8: Spain

In many respects, Spain is a typical example of the Southern European welfare system. While some scholars have viewed welfare states in Southern Europe as a sub-group of the Continental welfare model (Esping-Andersen, 1999), there are distinct institutional characteristics found in Italy, Spain, Greece, and Portugal that warrant a separate category for these countries (Castles and Obinger, 2008; Dolls et al., 2009, 2010; Ferrera, 1996). In fact, these institutional differences are quite significant in explaining the distinct social and political outcomes seen in Southern Europe since the start of the global financial crisis. While sharing many features of Continental welfare states, including pension systems, unemployment benefits, and labor market policies, based upon a logic of strong employment and wage protection, rather than social equality and universal coverage, there remain important differences (León and Pavolini, 2014). For example, in the fields of education and healthcare there is a departure in these countries from the corporatist traditions found in Continental systems and an adoption of more universalistic principles (Ferrera, 1996; León and Pavolini, 2014). At the same time, social assistance and family support policies are far more limited in Southern European welfare states than in Central Europe (León and Pavolini, 2014). The result of limited welfare services has led to a much greater reliance on the family as an informal source of social support and protection in Southern Europe than in other countries (Karamessini, 2007; Palme et al., 2009). Systems of employment and unemployment protection are strongly dualized in these countries resulting in large gap in social benefits between standard and non-standard employees (Moreno, 2000; Picot and Tassinari, 2014). In other words, we see similar labor market divisions between insider and outsider groups as found in Continental welfare systems, although the disparity between these groups is far more pronounced in Southern Europe due to the lower levels of social protection offered to outsiders and the high incidence of non-
standard work contracts. Overall, the defining features of the Southern European welfare model combine distinct institutions and principles that represent a unique welfare regime type that is different from that found in Continental Europe (Ferrera, 1996; León and Pavolini, 2014; Moreno, 2000).

In order to understand the differences between Southern European welfare systems and their Central and Northern European counterparts, it is also important to note the relatively recent development of the social protection systems in these Mediterranean states. While advanced welfare states emerged in Central and Northern Europe at the end of World War II, it was not until the democratic transitions of the 1970s that we see the emergence of the modern welfare state in Southern Europe. The experience of authoritarian rule in Southern Europe, in many respects, limited economic growth and the modernization process, resulting in underdeveloped welfare systems compared to the rest of Europe (Ferrera, 1996; Guillen, 2008; Moreno, 2000;). As a result of this later development, Southern European welfare systems are much smaller and less generous than their counterparts in Continental and Northern Europe (Moreno, 2000; Scruggs et al., 2014). The result is fewer social benefits and lower levels of protection for citizens against economic shocks. Since Continental welfare states are much larger by comparison, they provide significant automatic stabilizers, which protect citizens by increasing social spending during a crisis. By contrast, the smaller welfare states in Southern Europe lack these strong automatic counter-cyclical responses (Dolls et al., 2010). As a result, social policy decisions are far more subject to political debates and partisan divisions (Starke et al., 2012).
Spanish Welfare State Pre-crisis

Social Policy Expansion and Liberalization

After the death of Franco in 1975, Spain began a transitional period from authoritarian rule to a full democracy. By 1980, public social spending was only 17.1% of GDP, compared to the EU average of 21.9% of GDP (Guillen, 2008). However, throughout the 1980s and early 1990s, Spain saw significant expansion in terms of coverage and expenditures for welfare programs, particularly in universal education and health services (Guillen, 2008; Moreno, 2000). In 1986 the Spanish government adopted the General Health Act which provided universal health care for all citizens, which by 1991 covered 99.8% of the population (Almeda and Sarasa, 1996). Unemployment benefits were also expanded in the late 1980s and early 1990s to cover 50% of the unemployed population (Jeong, 2010). The government during this time also expanded access to primary and secondary education and provided scholarship funding for low-income families to gain entry into higher education (Moreno and Arriba, 1998).

Social expenditure increases during this early democratic period far outpaced economic growth, representing a significant investment on behalf of the Spanish government in developing the welfare state, which lagged behind many of its European counterparts. From 1975-1980 social expenditures grew annually at 8.9%, while GDP only increased an average of 1.8% each year (Moreno, 2000). Social spending as a percentage of GDP continued to grow significantly between 1980-1992 by 4.4%, higher than the EU average of 2.7% (Moreno, 2000). Although at 22.5% of GDP in 1992 social spending in Spain remained below the EU average of 27.1%, the rate of social spending expansion in Spain represented a clear process of catch-up with the more established European welfare states (Moreno, 2000).
Efforts toward welfare state expansion and economic liberalization were largely driven by Spain’s entry into the European Economic Community (EEC) in 1986 and its adoption of the Maastricht Treaty in 1992, which inducted Spain as a member of the European Monetary Union (Oliver-Alonso and Valles, 2005). European integration put pressure on the Spanish national government to bring the country’s welfare system closer to EU social standards, by extending universal health, education, and social protection benefits (Guillen and Alvarez, 2001; Oliver-Alonso and Valles, 2005). At the same time, Maastricht Treaty convergence requirements stressed Spain’s need to open its economy to international trade, adopt strict fiscal requirements, and liberalize aspects of its economy and labor market.

Beginning in the 1990s, Spain underwent additional welfare reforms that in addition to expanding social protection and closing welfare gaps, emphasized liberalization, efficiency, and fiscal discipline. The goal of these reforms was to bring greater competitiveness to the Spanish economy and increase labor market flexibility (Guillen, 2008). A particular area of focus was on the adoption of liberal labor market reforms and workforce activation measures to help increase employment for outsider groups. Due to a high degree of employment and wage protection for the core workforce and a traditional male-breadwinner model, Spain in the 1980s and early 1990s had one of the most rigid labor markets in Western Europe (Guillen, 2008). Between 1993 and 1994, a number of liberalization reforms were introduced to the Spanish labor market. Policies which encouraged job creation and the greater workforce participation of labor market outsiders were adopted, including tax and social contribution exemptions for companies hiring youth workers, the long-term unemployed, workers 45 years and older, and the disabled (Guillen, 2008). In addition, workforce development and job training programs were introduced to improve the quality of the workforce. Family and care policies also saw modest expansion in the 1990s in part to ease the
burden on women and encourage greater female workforce participation (Guillen, 2008). The goals of these labor market deregulation policies were to promote private investment and encourage economic competitiveness. These policies complimented efforts by the Spanish government to open the economy to international markets. A major feature of these reforms was the introduction and expansion of fixed-term contracts which allowed employers to hire and fire workers on a part-time basis far more easily. However employment protection policies and social benefits remained largely untouched for much of the core workforce.

Although fixed term contracts, introduced in the 1980s and 1990s, allowed for greater labor market flexibility, the core workforce in Spain retained high levels of employment and wage protection. These temporary contract measures, which quickly accounted for 30% of all salaried workers, allowed for the cyclical creation of employment during times of economic growth, but did little to offer stable employment and benefits to labor market outsiders (Guillen, 2008). As a result the Spanish labor market became more dualized and was unable to effectively reduce long term unemployment. Attempts to address this problem of dualization and further liberalize the core labor market were introduced in 1994, 1997, 2001, and 2006 although significant protection gaps remain for the long-term unemployed, non-standard workers, and new labor market entrants (Picot and Tassinari, 2014). Due to the continuous entry and exit from the labor market of nearly a third of the workforce, the costs of passive unemployment benefits grew significantly. As a result, the National Institute for Unemployment (INEM) almost faced bankruptcy during the 1990s and cost containment and retrenchment became necessary (Guillen, 2008).

While Spain had expanded welfare services to a wider portion of the population in efforts to bring the welfare state in line with other advanced countries, cost containment pressures to meet Maastricht fiscal requirements, led the government to introduce cutbacks in some social policy
areas in order to maintain deficit levels (Guillen, 2008). Whereas social expenditures as a percentage of GDP had expanded significantly during the 1980s and early 1990s, by 1993 these spending levels had peaked and would decrease throughout the rest of the decade (see Table 13). Social welfare benefits during this time were reduced in some areas. In 1992, for example unemployment protection policies became more restrictive and coverage rates fell dramatically from 80.3% in 1992 to 50.7% by 1995 (Ministerio de Trabajo, 1996, 803). This was the result of a government decree which introduced cuts to unemployment coverage, reduced the amount and length of benefits, tightened eligibility conditions, and increased work requirement periods from 6 months to 1 year (Royo, 2006). Although unemployment coverage had increased significantly since the Franco era, in the 1990s benefit rates were lowered and means tested benefits were introduced, rather than universal measures (Sanchez de Dios, 1998). Legislation introduced in 1985 led to substantial cuts in the social security system equivalent to around US$600 million (Beremo and Garcia-Duran, 1994). A series of rationalizing measures to reduce the cost of the pension system were also introduced in the 1980s and continued through the 1990s. This included the expansion of minimum contribution periods from 10 to 15 years and changes to the formula to calculate benefits in order to lower payments (Guillen, 2008). The private sector also took on a larger role in the pension system accounting for 40% of all workers (Guillen, 2008).

During the 2000s and up until the global financial crisis, the government continued to expand welfare services, while at the same time focusing on cost containment measures. In the area of family policy the government introduced paternity leave for public administration workers in 2006 and increased funding for public care facilities for children aged 0 to 3 years (Guillen, 2008). A national law, the Ley de Dependencia, was also adopted in 2006 which established a universal right to long-term care for individuals with reduced autonomy (León and Pavolini, 2014). Social
spending as a percentage of GDP, which had fallen since a high in 1993 also increased slightly and stabilized during this time period (see Table 13).

Table 13. Spanish Social Expenditure as a Percentage of GDP 1980-2006

Source: OECD Social Expenditure Database, 2015

Overall, Spanish welfare development in the period from the early democratization until the start of the global financial crisis can be characterized as one of both social policy expansion and liberalization. This evolution follows a very different trend from that seen in Continental Europe and can best be understood as driven by a desire for Spain to catch-up with the rest of Europe in terms of social coverage, while at the same time seeking to liberalize and improve the economy and labor market. In the early years, from 1980 until 1991, Spain’s integration into the EU allowed the government to justify policies designed to bring social spending in line with other EU member states with more developed welfare systems (Bernaciak, 2015; León and Pavolini, 2014). In many
respects, the signing of Maastricht Treaty in 1992 marked a shift in Spanish welfare development where the desire to expand social spending was coupled with an emphasis on efficiency and fiscal discipline. The strict macroeconomic convergence criteria required by the Maastricht Treaty to join the European Monetary Union put pressure on the Spanish government to focus on inflationary targets, deficits levels, and domestic spending limits.

As a result, previous goals of social spending catch-up often became secondary to concerns about cost containment, efficiency, and competition (Bernaciak, 2015). The strict benchmarks outlined in the Maastricht Treaty not only emphasized economic liberalization and privatization, but also constrained domestic decision making regarding social welfare policies (Ferrera, 2006; Guillen, 2008). The rising costs of newly adopted social programs and a growing focus on managing domestic spending and deficits help to explain the decrease in social expenditures as a percentage of GDP beginning in 1992 (see Table 13). Although this timeframe was marked by a new emphasis on liberalization, the Spanish welfare state did not face severe retrenchment through this period. Overall, during the period from the 1990s until the global financial crisis, Spain was faced with the same austerity concerns as their European counterparts; at the same time they were able to continue modest welfare program expansion to address protection gaps.

**Pre-Crisis Political Support for Welfare Expansion and Liberalization**

In terms of political conflict during this pre-crisis period, the need to catch-up with European social standards and the desire to meet Maastricht Treaty requirements led to considerable consensus across political parties and among the public in general. Since its accession into the EEC in 1986 and becoming a signatory to the Maastricht Treaty in 1992, there was a strong impulse among government leaders and the Spanish citizens to achieve social and economic convergence
with the other EU member states (León and Pavolini, 2014; Moreno, 2000). This desire to catch-up with the rest of Europe led both the center-right People's Party (PP), who were in power from 1996 to 2004, and the center-left Spanish Socialist Workers' Party (PSOE), who were in power from 2004 to 2011, to introduce similar policies to expand the coverage of social welfare while at the same introducing liberalization reforms in areas such as labor market protection (León and Pavolini, 2014). There was considerable cross-party support, for example, to promote legislative and institutional changes that would allow for greater female workforce participation (León 2011, Valiente, 2013). In the area of family policies, both conservative and socialist governments increased funding during their tenures in office (León and Pavolini, 2014). However, this expansion in coverage did not necessarily entail an improvement in the quality of benefits, nor did it prevent an increase in private sector care providers reflecting a liberalization of social support (León and Pavolini, 2014).

During its tenure in office from, 1982 until 1996 and again from 2004 to 2011, the socialist PSOE led government introduced comprehensive social policy reforms, by expanding access to welfare benefits, along with neoliberal economic adjustment measures to bring the budget and into balance (Magone, 2004; Solsten and Meditz, 1988). This included reducing employment and wage protection benefits to the core workforce as liberal labor market policies were introduced (León and Pavolini, 2014). The PSOE introduced certain restrictions to social benefits, such as reducing the length of unemployment support, as a means to cut welfare costs (Royo, 2006). While dedicated to improving the reach of the welfare state, the social and economic policies adopted by the PSOE in many ways reflected the prevailing neoliberal proscriptions the EU had put forth (Guillen, 2008). The conservative PP party, which ruled from 1996 until 2006, pursued a similar social and economic policy balance. While embracing a neoliberal economic policy agenda
focused on deregulation, market liberalization, economic competitiveness, and welfare cost containment, the PP did not make drastic cuts to the welfare system (Llamazares, 2005).

In many respects this policy approach of liberalization and social welfare expansion was driven by EU requirements and the desire to attain the standards of other member states. The EU integration process put pressure on the Spanish government to make liberal improvements to its economy, while at the same time improving the underdeveloped welfare state, which included the expansion of social benefit coverage and expenditures (Bernaciak, 2015). The overall result was a pre-crisis period in which parties on both the center-left and center-right sought to strike a balance between welfare state expansion and social and economic liberalization (León and Pavolini, 2014; Moreno, 2000). European integration also helps to explain continued public support for some of the harsh economic measures and welfare benefit restrictions that various governments adopted (Moreno, 2000). The underlying logic of catching-up with Europe allowed for significant restructuring of the labor market and the lowering of certain benefits held by the protected core workforce. For example, the social pacts adopted by unions and other social partners in both 1996 and 2006 introduced increased flexibility into the labor market by creating more open-ended contracts, modified part-time contracts as well as reducing the costs of laying off workers (Guillen, 2008).

By 2007, the Spanish welfare state had seen some vast improvements from its pre-democratic arrangements, with social policy provisions extended to a much broader range of the population and social spending much higher as a percentage of GDP. Pension and health care coverage, for example, was around 80-85% of the total population and unemployment benefits, despite some of the reductions introduced in the 1990s, and covered a much broader cross-section of the workforce (Guillen, 2008). Labor market reforms also introduced some flexibility, although the adoption of
more part-time contracts with limited social protection exacerbated issues of dualization and was not able to address persistent problems of unemployment (Picot and Tassinari, 2014). By the eve of the global financial crisis, the Spanish welfare state was significantly more developed in terms of coverage and expenditures than in the early democratic phase with social spending as a percentage of GDP over 5 points higher than its 1980 level (OECD, 2015b). However, despite these advances, the social protection system remained smaller than many other European counterparts with social spending as a percentage of GDP in 2007 at 20.3% well below the 25.3% average for EU member states (see Table 14). As the effects of the financial crisis became widespread, the implications of a weaker and less far reaching welfare system would have profound effects on the social conditions in Spain, with unemployment levels rising precipitously and coverage limited. Spain would also see much higher levels of political volatility and polarization than that seen in much of Central and Northern Europe.

**Table 14: Social Expenditures as a % GDP, EU-27, 2007**

<table>
<thead>
<tr>
<th>Member State</th>
<th>Total expenditure on social protection (% of GDP)</th>
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<tr>
<td>EU (27 countries)</td>
<td>25.3</td>
</tr>
<tr>
<td>Austria</td>
<td>27.0</td>
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<tr>
<td>Belgium</td>
<td>25.6</td>
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<tr>
<td>Bulgaria</td>
<td>13.7</td>
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<tr>
<td>Cyprus</td>
<td>17.8</td>
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<tr>
<td>Czech Republic</td>
<td>17.5</td>
</tr>
<tr>
<td>Denmark</td>
<td>29.3</td>
</tr>
<tr>
<td>Estonia</td>
<td>12.0</td>
</tr>
<tr>
<td>Finland</td>
<td>24.6</td>
</tr>
<tr>
<td>France</td>
<td>29.3</td>
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<tr>
<td>Germany</td>
<td>26.7</td>
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<tr>
<td>Greece</td>
<td>24.1</td>
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<tr>
<td>Hungary</td>
<td>22.3</td>
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<tr>
<td>Iceland</td>
<td>21.2</td>
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In the decade preceding the global financial crisis, Spain had seen steady economic growth with an average GDP growth rate of nearly 3.8% from 2000-2007 (OECD, 2015b). This was significantly higher than the Euro Area average of 2.2% during this same time (OECD, 2015b). Although Spanish unemployment in 2007 was at 8.2%, higher than the Eurozone average of 7.1%, this represented a decade low for the country (OECD, 2015b). The onset of the global recession, however, had a considerably negative effect on the Spanish economy. In the first two years of the crisis, from 2007 until 2009, Spanish GDP fell by 7.3% which though significant was slightly better than the 7.6% drop seen across the Eurozone as a whole (OECD, 2015b). While the decline in the Spanish economy in the aftermath of the crisis was lower than many other Eurozone member states, due in part to a high degree of labor market dualization and an over reliance on short-term

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<tr>
<td>Ireland</td>
<td>16.9</td>
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<tr>
<td>Italy</td>
<td>25.4</td>
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<tr>
<td>Latvia</td>
<td>11.0</td>
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<tr>
<td>Lithuania</td>
<td>14.0</td>
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<tr>
<td>Luxembourg</td>
<td>19.0</td>
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<tr>
<td>Malta</td>
<td>17.5</td>
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<tr>
<td>Netherlands</td>
<td>26.7</td>
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<tr>
<td>Norway</td>
<td>22.0</td>
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<tr>
<td>Poland</td>
<td>18.0</td>
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<tr>
<td>Portugal</td>
<td>22.6</td>
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<tr>
<td>Romania</td>
<td>13.2</td>
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<tr>
<td>Slovakia</td>
<td>15.5</td>
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<td>Slovenia</td>
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<tr>
<td><strong>Spain</strong></td>
<td><strong>20.3</strong></td>
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<tr>
<td>Sweden</td>
<td>28.3</td>
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<tr>
<td>Switzerland</td>
<td>23.3</td>
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<tr>
<td>United Kingdom</td>
<td>25.4</td>
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Source: Eurostat Social Protection Statistics 2015

**Spanish Welfare State Post-crisis**

*Crisis Management Stimulus Measures (2008-2010)*

In the decade preceding the global financial crisis, Spain had seen steady economic growth with an average GDP growth rate of nearly 3.8% from 2000-2007 (OECD, 2015b). This was significantly higher than the Euro Area average of 2.2% during this same time (OECD, 2015b). Although Spanish unemployment in 2007 was at 8.2%, higher than the Eurozone average of 7.1%, this represented a decade low for the country (OECD, 2015b). The onset of the global recession, however, had a considerably negative effect on the Spanish economy. In the first two years of the crisis, from 2007 until 2009, Spanish GDP fell by 7.3% which though significant was slightly better than the 7.6% drop seen across the Eurozone as a whole (OECD, 2015b). While the decline in the Spanish economy in the aftermath of the crisis was lower than many other Eurozone member states, due in part to a high degree of labor market dualization and an over reliance on short-term
contracts, the unemployment rate rose precipitously from 8.2% in 2007 to a staggering 26.1% by
2013 (OECD, 2015b; Picot and Tassinari, 2014). The unemployment rate for labor market
outsiders, which had always been higher than for the core workforce in Spain, was far worse.
Workers who were hired on short-term contracts faced mass layoffs in the wake of the crisis. As a
result, certain segments of the population, most notably younger workers, were disproportionately
affected by the severe economic slowdown both in terms of employment and social protection
(Dellepiane and Hardiman, 2012; OECD, 2010b). In 2006, youth unemployment, which was
perpetually high, had reached a ten year low of 17.9% (OECD 2015b). In the aftermath of the
economic collapse youth unemployment rose to a shocking 55.5% by 2013 (OECD 2015b).

As the crisis progressed, many of the short-term employment contracts, that a large percent of
Spanish workers relied upon, were not renewed, resulting in large-scale pro-cyclical
unemployment throughout the country (Picot and Tassinari, 2014). The collapse of the housing
market in Spain only contributed to the worsening economic conditions and poor employment
performance as workers in the construction sector faced massive layoffs (Bentolila et al., 2012;
Royo, 2009). In response to this dramatic economic downturn, the center-left PSOE government
adopted generous stimulus measures beginning in 2009 to counteract the harmful social and
economic consequences of the crisis. The package introduced by the PSOE government was one
of the biggest stimulus packages of any European country in terms of share of national GDP worth
€12.31 billion equivalent to 1.1% of GDP (European Parliament, 2009; Watt and Nikolova, 2009).
Nearly half of these funds, €5.9 billion representing 0.5% of GDP, were dedicated to employment
policies and household support measures (European Parliament, 2009). The PSOE led government
also introduced a temporary €420 monthly payment for long-term unemployed workers who had
exhausted standard welfare benefits (Picot and Tassinari, 2014; EurWork, 2009). These policies
passed despite opposition from the conservative PP who argued that it would be costly and do little to address the underlying causes of unemployment (EurWork, 2009). This opposition, however, highlights growing political divisions between parties on the left and right over appropriate fiscal responses to the recession.

Whereas concerns over cost-containment were pervasive across parties in the pre-crisis period, the center-left government believed that the severity of the crisis necessitated a strong central government response in the form of fiscal stimulus. The stimulus package introduced by the PSOE combined tax cuts and social spending increases as a way to provide counter-cyclical support that would improve demand, encourage growth, and reduce high unemployment levels. The types of measures and generosity of the social spending response in many regards reflected the partisan orientation of the government as Prime Minister Zapatero stressed the Social Democratic motivation behind these policies (Dellepiane and Hardiman, 2012). These Keynesian policies were in stark contrast to the fiscal adjustment strategies adopted by liberal countries, such as Ireland and the UK, who sought to reduce public expenditures and implement austerity measures (Dellepiane and Hardiman, 2012). This initial fiscal stimulus response by the Spanish government was also consistent with 2008 European Economic Recovery Plan put forth by the European Commission, which emphasized the necessity of counter-cyclical spending to reduce the economic consequences of the crisis (European Commission, 2008).

Although the fiscal stimulus response of the Spanish government was considerable, as a percentage of GDP, it was still smaller in overall value than that of wealthier EU member states such as France, Germany and the UK (European Parliament, 2009). Importantly, due to the smaller size of its welfare system the financial crisis was met in Spain with a weaker automatic stabilizer effect. In fact automatic stabilizers in Spain accounted for only 28% of income shock absorption
(Dolls et al., 2012). This was far below the EU average of 38% and among the lowest in the region
(Dolls et al., 2012). The automatic stabilizer response for the job market was similarly weak
accounting for only 38% of the unemployment shock after the crisis compared with an EU average
of 47% (Dolls et al., 2012). The automatic stabilizer effects on unemployment in Spain were also
considerably lower than states in Central and Northern Europe, for example, these automatic
stabilizers account for 82% of unemployment shock absorption in Denmark, 68% in Sweden, and
62% in Germany (Dolls et al., 2012). As we have seen in other European cases automatic
stabilizers have played an important role in providing an immediate buffering against the effects
of the crisis. Whereas countries in Northern and Central Europe were able to limit unemployment
and income loss through automatic social spending increases, Spain and its counterparts in
Southern Europe had much more limited responses. As a result, we see far higher levels of
unemployment and social instability in this region compared to other parts of Europe with more
mature and comprehensive welfare systems. Overall, the weaker automatic stabilizer response
meant that social protection measures to address the effects of the crisis in Spain had to be
addressed through discretionary spending. This has allowed for more political contestation over
social policies and helps to explain the pronounced political divisions that have emerged in Spain
between parties on the left and right since the start of the crisis.

Politics, Fiscal Discipline, and Austerity (2010 – Present)

While the center-left PSOE government was able to introduce increases in social protection at
the start of the crisis, slow growth and continued problems with soaring unemployment led to a
sharp rise in public expenditures (Picot and Tassinari, 2014). This led to a considerable increase
in Spanish public debt as the crisis continued. Whereas Spanish debt was a mere 41.7% of GDP in
2007 by 2014 it was at 117.7% representing a huge increase (OECD, 2015b). As it became clear that the Spanish economy was facing more than a temporary downturn, the government came under increasing pressure, particularly from EU institutions, to adopt deficit reduction measures (Dellepiane and Hardiman, 2012). As the crisis persisted and concerns over sovereign debt repayments increased, the European Commission, which had initially encouraged strong stimulus responses as part of the European Economic Recovery Plan, began to argue that fiscal increases should be temporary and that by 2010 member states should begin to cut spending in order to balance public accounts (European Parliament, 2009). In May 2010, the Eurogroup, an informal collection of Eurozone finance ministers, met and demanded that Spain adopt strong austerity measures to reduce deficit spending and lower public debt (Picot and Tassinari, 2014).

This pressure came to a head in 2010 due to growing financial market uncertainty stemming from fears over Greek sovereign debt repayments. In response to international pressure, the Spanish government proposed a budget in 2010 which phased out the high levels of stimulus spending that had been introduced at the start of the crisis. Importantly, however, the PSOE sought to make these deficit reductions not by cutting spending, but through tax increases such as ending a tax rebate scheme and raising the VAT which increased tax revenue by about 1.5% of GDP (Dellepiane and Hardiman, 2012). The clear goal of this approach was for the socialist government to lower costs, while at the same time maintaining high levels of welfare spending and continuing to provide support to a large number of unemployed citizens. This agenda was in contrast to the conservative PP opposition party who argued in favor of large spending cuts (Dellepiane and Hardiman, 2012). This policy approach in the face of austerity is in marked contrast to other liberal welfare states, such as the UK and Ireland, who implemented widespread and deep cuts to their welfare systems in order to balance costs (Dellepiane and Hardiman, 2012).
However, despite attempts to insulate workers and citizens from welfare cuts the PSOE was eventually encouraged, under mounting international pressure from the European Commission and ECB, to reduce social spending levels (León and Pavolini, 2014). In line with Eurogroup recommendations, in May 2010, the Spanish government adopted an emergency budget which aimed at making €15 billion in spending cuts over the course of 2010 and 2011 with the goal of lowering the national debt (Dellepiane and Hardiman, 2012). These new measures included cuts to public sector wages by 5% and 15% to politicians’ wages, along with reductions in child welfare and pension benefits (Guardian, 2010). These social spending cuts highlighted the stress placed on the socialist government to introduce fiscal reductions, despite the PSOE’s attempts to resist market pressures to do so. Even though spending cuts were eventual adopted, the PSOE maintained its ideological commitment social welfare spending, rather than embracing a liberal pro-austerity agenda (Dellepiane and Hardiman, 2012). In fact, although cuts were eventually introduced, the PSOE was able to rely on tax revenue for about 60% of fiscal adjustments (Dellepiane and Hardiman, 2012). In other words, even after facing mounting pressure from the European Commission and the ECB to reduce deficit spending the center-left PSOE government sought to insulate social programs from severe cuts and protect core components of the welfare state.

The Crisis and Growing Political Divisions

The necessity for fiscal consolidation, while prudent to address Spain’s financial concerns, took its toll on the PSOE who lost the support of unions and other left leaning parties. The adoption of greater fiscal discipline also led to a considerable loss of confidence in the government among the public and growing support for the center-right opposition PP party (see Figure 2). Throughout this timeframe the PSOE faced significant opposition from the PP, even after adopting greater
spending cuts (Dellepiane and Hardiman, 2012). This culminated with significant electoral losses for the PSOE in the national elections at the end of 2011, the party’s worst performance ever, and a clear majority for the center-right PP (Guardian, 2011). This election would mark a clear shift toward more conservative fiscal management in Spain.

**Figure 2. Voting intentions in Spain, PSOE vs PP, 2008-2011**

![Graph showing voting intentions in Spain, PSOE vs PP, 2008-2011](image)

Source: Dellepiane and Hardiman 2012

Whereas the PSOE had resisted cuts to the Spanish welfare state, the PP embraced austerity measures and social spending reductions. With a clear majority, the conservative government in Spain, under the leadership of Mariano Rajoy, started implementing fiscal cuts and structural reforms. These actions were in stark contrast to the policies adopted by the PSOE in the earlier phase of the crisis which were concerned with cushioning against the effects of the economic...
downturn (Picot and Tassinari, 2014). In many respects, these changes were of a more ideological nature, emphasizing the primacy of fiscal discipline and neoliberal reforms, which undermined much of the Keynesian stimulus measures that were introduced by the PSOE (León and Pavolini, 2014). Even when the PSOE eventually conceded to modest spending cuts, the party maintained its commitment to social democratic values adopting welfare retrenchment out of necessity rather than preference and taking efforts to insulate core social programs from reductions. The PP legislative agenda however, reflected a clear neoliberal response strategy to the ongoing crisis.

In July 2012, the PP led government adopted sweeping social spending cuts and tax increases worth €65 billion (Guardian, 2012a). These austerity measures included cuts to unemployment benefits, a change in the retirement age requirements to 68 years, and reductions in public sector wages as well as the closure of state-owned industries and the privatization of national ports, railroads, and airports (Guardian, 2012a). These austerity measures, while the largest and most sweeping, were the fourth adopted by the PP since coming to power seven months earlier (Bloomberg, 2012). These reforms came as Spain’s economy continued to struggle from the effects of the financial crisis and fiscal concerns mounted. Public debt had risen to 92% of GDP by 2012 up from 41.7% in 2007 and the reported government budget deficit for the previous year was at of 8.9% of GDP (OECD, 2015b; Wall Street Journal, 2012c).

In addition, to pressure from international financial markets to adopt fiscal consolidation, the EU had a strong influence over the types of policies that the PP adopted. In the days preceding the July 2012 austerity reforms, the Spanish government had been in negotiation with the EU for €100 billion in bailout funds to prop up the struggling banking sector (Guardian, 2012a). Bailout requirements included strict conditions, such as the adoption of deficit reduction strategies through tax increases and social spending cuts (Guardian, 2012b). These requirements reflected a shift in
EU policymaking from stimulus toward austerity beginning in 2010. As concerns over sovereign debt, particularly in Europe’s periphery grew, the European Commission and the ECB along with the IMF put considerable pressure on states with high deficit problems to make drastic across-the-board public spending cuts (León and Pavolini, 2014). These conditions further strengthened arguments that austerity was the only viable policy response to the growing crisis already embraced by the conservative PP government. The role of the EU in Spain’s recovery also highlights important dimensions of the interaction between EU authorities and member states. First, it indicates the importance that economic concerns over growth and competitiveness had over social issues. Second, these policy negotiations confirm the influence that the EU has over the direction of national social policies (del Pino, 2013).

Along with the social spending reductions that were part of the 2012 austerity package, the PP also introduced €6 billion in cuts from the National Health Service (Social Europe, 2012). Drastic cuts were also made to gender equality policies, childcare, long-term elderly care, and other family support benefits (León and Pavolini, 2014). The center-right government was also able to use the crisis and external pressure to push through deregulatory reforms in line with its liberal political agenda (Picot and Tassinari, 2014). For example, in 2012 the PP introduced far-reaching labor market reforms to introduce greater labor market flexibility and reduce labor costs. Collective bargaining was decentralized, giving priority to firm-level over industry-wide agreements, which shifted the balance of power in favor of employers rather than unions (Picot and Tassinari, 2014). Employment protection was lowered for workers with permanent contracts and the cost gap between firing full-time and temporary employees was decreased (Picot and Tassinari, 2014). These policies represented a liberalization of the Spanish labor market and an attempt by the government to address issues of dualization in the economy. However, at the same time that
employment protection policies were weakened these measures were not coupled with support for labor market outsiders or restrictions in the use of temporary contracts (Picot and Tassinari, 2014). There was also no increase in unemployment benefits or a significant expansion of active labor market policies, such as job training programs, as part of these reforms (Picot and Tassinari, 2014). In sum, the policies pursued by the center-right PP government have constituted the largest cuts in social spending since democracy was established in Spain and have included some of the most transformative labor market reforms in recent history (Social Europe, 2015).

While successful in lowering budget deficits and making the labor market more flexible, the austerity measures put in place by the PP government, have led to a considerable increase in political tensions within the country fueled by high unemployment and economic recession. In opposition to the PP’s austerity measures, the PSOE adopted a new party platform in 2013 which included commitments to remove income tax requirements for the unemployed and pensioners, repeal the labor reforms adopted by the PP, and increase funding for pensions, healthcare, family care, and education (Euro Intelligence, 2013). This new platform for the PSOE marked a clear shift to the left for the party and highlighted the growing divide between the policies of the center-left and center-right. The PP has also faced growing opposition from far-left parties who have capitalized on growing disenchantment amongst the public with austerity measures.

In response to the PP’s proposed 2013 budget, which sought to cut €150 billion from government spending between 2012 and 2014 through further tax increases and welfare cuts, thousands of protesters took to the streets of Madrid (BBC, 2012a). The protests were in opposition to what many perceived as a systematic dismantling of the welfare state by the conservative PP government (Social Europe, 2012). The protests in Madrid, in response to the 2013 budget, were part of a larger grassroots movement called Los Indignados which organized ongoing protests and
demonstrations against the austerity measures put forth by the Spanish government and promoted by the EU (BBC, 2012b). These protests have been part of a growing anti-austerity movement that has swept through much of Southern Europe, as citizens disenchanted with social conditions and economic policies, have demanded more social assistance, rather than welfare retrenchment. In this regard, we have seen increased politicization of social and economic policies throughout the region as public dissatisfaction with austerity has grown in countries such as Greece, Italy, and Spain.

In addition to popular unrest in the streets, Spain has also seen greater contention within politics and the rise of the populist far-left Podemos party, which has gained increasing support over traditional center-left and center-right parties. Podemos, grew out of Los Indignados a grassroots protest movement, and established itself as a political party in 2014 with the publication of its founding manifesto, which outlined the need to adopt radically different policy solutions to address the problems of inequality, unemployment, and slow economic growth stemming from the European debt crisis (Schofield and Caballero, 2015). In particular, Podemos has called for the end to austerity measures in Spain, the restructuring of Spanish debt, and an increase in social protections for all citizens, including a rise in the minimum wage, a return of the retirement age to 65, and the annulment of the PP labor market reforms (Junor 2015; Open Europe, 2014). Podemos in many respects owes its origins to the Los Indignados movement and a growing discontentment with both center-left and center-right mainstream parties. According to a public opinion poll administered in November 2014 by Spain’s leading newspaper, El Pais, Podemos was supported by 27.7% of the population, compared with 26.2% for the center-left PSOE and 20.7% for the ruling conservative PP party (Junor, 2015). This was the first time that the new party had come ahead of two traditional mainstream parties, indicating a massive shift in Spanish politics. In fact
within a year of its establishment, Podemos' party membership had reached over 283,000 members making it the second largest party in Spain after the PP (Junor, 2015).

Podemos increased support at the expense of more traditional PSOE and PP parties has been part of a rising trend of public dissatisfaction with the two main parties. In fact, the PP and PSOE saw their joint share of the national vote decline nearly 10% from 83.3% in 2008 to 73.4% by 2011 (Funke et al., 2015). This trend continued in regional elections, where although the PSOE and PP were able to maintain their status as the two leading parties saw a sharp decline in their share of the votes. Whereas the combined the PP and PSOE accounted for 65% of the vote in the 2011 regional and municipal elections, this had fallen to 52% of the total vote in 2015 (Economist 2015). This was the worst local election result for the PP in twenty years as the party saw its share of the vote drop by 10 percentage points (Reuters, 2015, Wall Street Journal 2015a). This loss of vote share can largely be attributed to the entrance of alternative parties, like Podemos and the newly established right wing Ciudadanos, into the Spanish political sphere and the radicalization of the electorate (Wall Street Journal, 2015a). The anti-austerity message put forward by Podemos has resonated deeply with the Spanish people and reflects significant changes in public faith in the government since the start of the crisis. Podemos is also likely to have a disruptive effect in national politics and poses a serious threat to the Spanish political establishment. The introduction of Podemos into Spanish politics, therefore, has led to a significant reordering of the political landscape in the country and has led to increased tensions between advocates and opponents of austerity over the types of social and economic policies which should be pursued by the state.

In addition to the significant impact that the emergence of Podemos has had on domestic politics within Spain, the party has also had an important influence over politics at the European level. In the 2014 European Parliamentary elections, Podemos received nearly 8% of the vote
earning five seats, a surprising success for a party that had been established less than half a year earlier (European Parliament, 2014). As a result of this election, for the first time the two main ruling parties, the PP and PSOE, were denied a majority of votes (New York Times, 2015b). Podemos’ electoral success reflected a larger upset of the status quo within the European Parliament as parties on both the far-left and far-right made significant gains over traditional centrist parties. In Greece, the far-left Syriza party won a large majority in the European Parliamentary elections garnering 26.57% of the vote earning six seats (European Parliament, 2014). Clearly aligning himself with the Syriza, Pablo Iglesias, the leader of Podemos, made statements in the wake of his party’s success in European Parliamentary elections that by pursuing austerity in Greece and other peripheral states EU leaders and the IMF were threatening the European project and undermining democracy in the region (Reuters, 2015d). These statements offered a signal of solidarity with other far-left parties in Europe and a challenge to the austerity policies pursued by the EU, the ECB, and member states such as Germany. In many respects, the success of parties like Podemos and Syriza marks an important shift in European politics as resistance to fiscal discipline has become fiercer and calls for alternative policies to provide greater social protection have grown. In sum, the emergence of the far-left Podemos in Spain reflects an increased politicization of social and economic policies and an electoral push toward the political fringes since the start of the crisis. This rise of Podemos has provided further momentum to growing anti-austerity sentiments both domestically in Spain and within Europe which have profoundly changed the political landscape creating conflict over austerity and the role of the welfare state in the aftermath of the crisis.
Conclusion

While dissimilar from many of its Central and Northern European counterparts, the development of the welfare state in Spain followed a path similar to many countries in Southern Europe. After a transition to democracy in the mid-1970s, the government was dedicated to an expansion and modernization of the social protection system with the goal of bringing it closer in line with the more developed social institutions of other EU members. Throughout the 1990s and 2000s, this objective of welfare expansion was coupled with a desire to liberalize and promote efficiency within the system. In other words, the process of Spanish welfare development in the pre-crisis period can be seen as one of social service expansion in terms of coverage and liberalization with the introduction of cost-containment measures. The adoption of the Maastricht Treaty in 1992 created a strong incentive for government leaders to achieve social and economic convergence with the other EU member states and resulted in considerable consensus across political parties and among the public (León and Pavolini, 2014; Moreno, 2000). The desire to catch-up with the rest of Europe in terms of social and economic standards led centrist parties on both the left and the right to introduce similar policies to expand welfare coverage and introduce liberal reforms in areas such as the labor market (León, 2011; León and Pavolini, 2014; Valiente 2013). Overall, the social policies in the pre-crisis period were relatively depoliticized as prevailing European notions of how best to expand and reform the welfare state were embrace by the main political parties within Spain.

Whereas cost containment concerns dominated Spanish policymaking before the crisis, in the immediate aftermath of this event the center-left PSOE government adopted a series of stimulus measures to offset the social and economic costs of the crisis. However, a high degree of labor market dualization and an overreliance on flexible part-time contracts led to large scale
layoffs as economic conditions worsened. Unemployment in Spain soared in the wake of the crisis, with nearly a quarter of the population out of work and results far worse for labor market outsiders, like youth workers who faced an unemployment rate above fifty percent. Due to the smaller size of the Spanish welfare state, relative to other EU members, and the weaker automatic stabilizer response limited social protection was offered to unemployed citizens who faced worsening economic conditions and poor prospects for returning to the workplace. As economic conditions deteriorated and demand for unemployment and other social assistance continued to rise the Spanish government was faced with worsening fiscal circumstances.

In 2010, fears over a possible Greek default on its national debt created instability in European markets led the EU to emphasize the necessity of fiscal austerity to bring domestic finances back in order. Despite adopting a generous stimulus package, the center-left PSOE was gradually pressured to implement austerity measures and social welfare cuts, although the party resisted these attempts and sought to use tax increases, rather than social spending cuts to lower its deficit. Although ultimately capitulating to some austerity demands, the PSOE leadership maintained its commitment to social democratic beliefs emphasizing that these liberal reforms were being adopted out of necessity not out of ideological commitment. These policies however, led to considerable unpopularity for the PSOE resulting in an electoral victory for the conservative PP party in the 2011 general elections. Unlike the PSOE, the PP was ideologically more attuned to liberal policy recommendations for how best to address the crisis. Under PP leadership, Spain accelerated its fiscal consolidation process and severe cuts were made to the welfare state. This marked a considerable turn away from early stimulus measures and reflected a growing emphasis on austerity throughout Europe.
A consequence of these austerity measures, however, has been increasing social and political volatility within Spain. High unemployment, continued economic recession, labor market dualization, and a limited welfare response has led to serious social conflict within Spain and increasing political polarization. Since being removed from office, the center-left PSOE has adopted a more progressive policy platform indicating growing differences between the two main political parties (Euro Intelligence, 2013). At the same time, increasing popular unrest over austerity measures has led to a politicization of social and economic policies and a radicalization of the electorate with parties, such as the far-left Podemos, taking considerable support away from the traditional PP and PSOE parties. This shift to the far-left has not only dramatically transformed domestic Spanish politics, but has led to considerable contestation at the European level over the austerity policy agenda. The success of Podemos and other anti-austerity parties in the European Parliament, such as Syriza in Greece, has created conflict between advocates of fiscal discipline, such as Germany and the ECB, and dissatisfied citizens within peripheral states who perceive austerity measures as anathema to economic recovery and social stability.

In sum, Spain has witnessed a degree of political conflict not seen before the crisis. There has been a growing divide between the two main centrist parties as the center-left PSOE has shifted its political platform further to the left. Domestic politics has also seen high levels of support for newly created parties at the political extremes, which have undercut the traditional party system in Spain. This political sea change has also had an important influence at the European level and may potential generate significant changes to the policy agenda for the entire region. While the long-term influence of Podemos has yet to be determined, national political dynamics in Spain will likely be heavily influenced by non-traditional parties at least for the foreseeable future. At the heart of the political conflict in Spain is the debate over whether the government should continue
its policies of austerity or whether populist resistance will create pressure for alternative policies to be adopted. These new political dynamics will be critical to understanding the development of social and economic policies in Spain and throughout the EU in coming years.
Chapter 9: The Czech Republic

The social protection system that developed in the Czech Republic after the fall of the USSR, in many respects, is representative of a distinct Eastern European welfare regime type that emerged in the region (Arts and Gelissen, 2002; Aidukaite, 2009a, 2009b, 2011Fenger, 2007; Cerami, 2010; Cerami and Vanhuysse, 2009; Golinowska et al., 2009). While there are of course some variations in welfare state development between Eastern European countries, there are important similarities in terms of both historical legacies and the types of institutions and policies which were adopted by national governments in response to the challenges of post-communist transition. These distinct institutional features of the Eastern European welfare system provide an important explanation for the social and political outcomes that occurred in the Czech Republic in the wake of the global economic recession.

Perhaps the most influential historical precedent in the development of the contemporary welfare state in Eastern European countries, such as the Czech Republic, can be traced to the Bismarckian social system with its corporatist structures and generous social and health insurance schemes funded largely through compulsory employee contributions (Potůček, 2009; Żukowski, 2009). This system was present prior to Communist rule in the Czech Republic and can be seen in present day social provisions, including pension systems, unemployment benefits, and labor market policies, based upon a logic of strong employment and wage protection, rather than social equality and universal coverage (Deacon, 1997; Potůček, 2009). In the case of the health insurance system that was adopted after 1989, the Czech government and public opinion overwhelmingly supported a system of health coverage financed by compulsory employee, employer, and state contributions, rather than a more universal system funded through general taxation (Potůček, 2009).
However, whereas eligibility for benefits in Continental systems are primarily based on labor market participation, the social security system in the Czech Republic exhibits more universalistic tendencies (Aidukaite 2011; Potůček, 2009). This embedded universalistic approach reflects the legacies of the communist system, in which social protection was part of the central planned economy. The Soviet welfare state was predicated upon a mix of corporatism and universalism. Due to the near full employment the corporatist Soviet social system was effectively able to achieve universal coverage (Cerami, 2010; Standing, 1996). In the case of pensions, for example, although benefits were supposed to be linked to professional status, wage equalization in the communist system led to flat-rate benefits for everyone (Cerami, 2010). Healthcare under the USSR, was also universal and free to all citizens through a centralized national health care system (Kornai, 2001). Household social support and family benefits were also extensive and aimed at encouraging full employment of both men and women (Cerami, 2010). These universalistic tendencies have continued in some areas of the Czech welfare system, including old age pensions, disability payments, and healthcare, where full coverage is provided for all citizens (Żukowski, 2009). After the collapse of the Soviet system these universal social security mechanisms were a core feature of the Czech government’s initial response to rising challenges of unemployment and low economic growth (Aidukaite, 2011).

It is important to note, however, that although the Czech Republic offers more universal social welfare coverage than many of its Continental European neighbors, the levels of social security benefits are far lower (Aidukaite, 2011). Social spending as a percentage of GDP in 2007, prior to the global financial market collapse, was 17.5% well below the EU average of 25.3% (Eurostat, 2015). During the 1990s and 2000s, there were also increasing efforts to liberalize social policies across Eastern European welfare states which coincided with broader neoliberal economic reforms
(Aidukaite, 2011; Potůček, 2001, 2009; Saxonberg and Sirovátka, 2009). The Czech welfare state, therefore, incorporates many of the features of the other welfare regime types, while maintaining certain arrangements that constitute a distinct Eastern European welfare state. This regime offers high social protection coverage, low levels of social spending, limited means tested benefits, and residual liberal elements throughout the social protection system (Aidukaite, 2011).

Beyond the unique mix of welfare arrangements present in Eastern European welfare state, to fully understand their development, and its implications in light of the global financial crisis, it is critical to look at the post-communist transition of these systems. Whereas the advanced welfare state developed in Central and Northern Europe at the end of World War II, it was not until the post-communist democratic and economic transitions of the 1990s that we see the emergence of the modern welfare state in Eastern Europe. The collapse of the Soviet Union in 1989 had a profound impact across Eastern Europe creating fundamental changes in the social and economic context under which citizens lived and governments operated. States within the former Soviet Bloc not only gained independence, but underwent an abrupt shift from a centrally planned communist system to free market economies and from authoritarian rule to democratic pluralistic forms of government (Potůček, 2009). During this transition economic growth and labor market concerns became major issues. Whereas the Soviet system created near full employment, the economic transition toward a free market economy led to huge changes in the labor market, including decreased demand for workers and rising unemployment (Potůček, 2009). To address these concerns social policies were introduced, such as compulsory health and social insurance, active labor market policies, and means tested minimum protection for all citizens (Potůček, 2001). At the same time that there were incentives to provide comprehensive social protection, increases in
unemployment taxed these new systems and pressure to liberalize social policies grew (Potůček, 2001).

The legacy of Soviet rule in Eastern Europe effectively limited the establishment of the modern welfare state, leading to underdeveloped social protection systems compared to the rest of Europe. A result of this later development and the economic pressures of post-communist transitions, by the start of the global crisis Eastern European welfare states were much smaller, less generous, and less efficient than their counterparts in Continental and Northern Europe (Eurostat, 2015). The result has been fewer social benefits and lower levels of protection for citizens against economic shocks. Since Northern and Continental European welfare states are much larger by comparison, they provide significant automatic stabilizers, which protect citizens by increasing social spending during a crisis. In contrast, the smaller welfare states in Eastern Europe lack these automatic counter-cyclical responses and offer less of an immediate buffer against the negative effects of economic downturn (Dolls et al., 2010). Social policy responses, therefore, have been adopted piecemeal through discretionary spending. As a result, the decision to increase or decrease social spending has been predicated upon more ideological beliefs and subject to partisan division.

Czech Welfare State Pre-crisis

Social Policy Expansion and Liberalization

Czechoslovakia gained independence from the Soviet Union in late 1989 through a series of non-violent protests known as the “Velvet Revolution”. This political reordering led to the end of 41 years of communist rule and a transition from an authoritarian government toward a parliamentary republic and a free market economy. Shortly after gaining independence, the Czech government adopted a plan for a coherent social system which would offer universal compulsory
social insurance and health coverage combined with means tested welfare assistance to all citizens (Potůček, 2009). Effectively this system sought to replace state paternalism with a more decentralized and efficient welfare state. These reforms were informed by the social protection systems in place in EU member states and the liberal economic changes that were taking place in the country at the time (Potůček, 2009). This restructuring of the welfare system coincided with serious social problems resulting from the post-communist transition, including recession, high inflation, rising unemployment, widespread poverty, and deteriorating living standards (Aspalter et al., 2009; Cerami, 2010). As a consequence, many of the early social policies adopted by the Czech government after 1989 can be characterized as an emergency response to the social costs of political and economic change (Horibayashi, 2006; Offe, 1993). In other words, the social policies put in place were intended to provide an effective safety net for citizens during a time of intense political and economic upheaval. These measures included, the establishment of a new compulsory social insurance system which would provide universal benefits for the unemployed, families, the disabled, and pensioners (Potůček, 2009). Bills adopted in the early 1990s, including the State Social Support Act, Subsistence Level Act, and the Social Need Act, established a commitment on behalf of the state to guarantee a basic standard of living for citizens above an official minimum level of subsistence (Orenstein, 1995; Potůček, 2009).

While the first few years of post-communist transition saw the introduction of emergency measures to address social concerns, such as rising unemployment, during the early to mid-1990s the Czech government began to adopt a more liberal social policy approach that can be attributed to both internal and external reform pressures. By 1992\textsuperscript{14}, a new government came into power which emphasized the need to embrace neoliberal economic reforms and a more limited

\textsuperscript{14} During this same year, Czechoslovakia peacefully divided into two independent states, the Czech Republic and the Slovak Republic.
role of the state in providing social security (Potůček, 2009). These changes to the nature of social policy provisions grew from increased budgetary pressures domestically, and the growing acceptance of neoliberal norms throughout Eastern Europe advocated for by international organizations, such as the IMF and World Bank (Horibayashi, 2006). This emerging neoliberal social policy agenda for the region emphasized means-tested targeting of benefits along with reforms and privatization of old age pensions and healthcare. (Deacon, 1997). Eligibility requirements for unemployment benefits in the Czech Republic, for example, became more restricted during the 1990s. Whereas unemployment benefits were paid for an entire year in 1991 at 90% of earnings for the first 6 months and 60% of earnings thereafter, the length and generosity of the entitlement was reduced so that by 1999 only 50% of earnings were paid in the first 3 months and 40% of earnings for the next 3 months (Horibayashi, 2006). Due to increased restrictions, those eligible for unemployment benefits also declined from 72% in 1991 to 50% of the population by 1996 (Adam, 1999). In addition to unemployment measures, liberal reforms also took place across a number of other social policy areas during this time.

In 1995, there was a significant legislative change in the structure of old age pensions which saw the retirement age increase for women from 53-57 to 57-62 (depending on the number of children) and from 60 to 62 for men (Potůček, 2009). This age limit was raised again in 2003 to 63 for men and women without children (Potůček, 2009). This followed the introduction of voluntary private pension insurance in 1994, which offered a market based alternative to state social assistance. Average old-age pensions compared to average net wage decreased from 66% in 1990 to 52.7% in 2006. Similarly, average old-age pensions compared to average gross wages decreased from 52.7% in 1990 to 40.8% in 2006 (Potůček, 2009). In sum, not only did pension
eligibility become more restricted in the Czech Republic, but benefits decreased relative to average wages leaving the possibility that some retirees could fall below the subsistence level.

Similar liberal changes were made in 1995 to family and children support benefits. While benefits had previously been guaranteed to families with dependent children, the 1995 State Social Support Act introduced means-tested measures that would limit eligibility to families whose income was 1.8 times above the social minimum (Horibayashi, 2006). In 1996, the social insurance system became more targeted as the Czech government sought to limit the universality of programs (Orenstein and Haas, 2005). A number of health care facilities were also privatized during this timeframe and voluntary private health insurance policies were introduced in 1993, reflecting a liberalization of the health services in the country (Potůček, 2009).

Although there were clear liberal residual tendencies in Czech social policies during the 1990s and 2000s, this did not constitute a convergence with more liberal welfare regimes and some social services were even expanded during this time. In fact, while economic liberalization was a core feature of post-communist transition throughout Eastern Europe, many states, including the Czech Republic, maintained high levels of social spending. While social spending as a percentage of GDP was at 14.6% in 1990, it reached a high of 19.6% by 2003, representing a significant increase in overall welfare support (see Table 15). It is important to note, however, that although social spending as a percentage of GDP actually grew in the Czech Republic, and in many other Eastern European states, it fell in absolute levels corresponding with overall declines in GDP. (Orenstein and Haas, 2005). Despite this decline in absolute levels, during the period from independence until the global financial crisis, the Czech Republic did not see strong welfare retrenchment. Instead, social spending increased representing a process of catch-up with other
more established European welfare states. The Czech social protection system, however, remained smaller than its EU counterparts in terms of GDP expenditures and absolute levels of support.

Table 15. Czech Republic Social Expenditure as a Percentage of GDP 1990-2007

![Graph showing Czech Republic Social Expenditure as a Percentage of GDP 1990-2007]

Source: OECD Social Expenditure Database, 2015

Orenstein and Haas highlight a significant “Europe effect”, which helps to explain the continued welfare support in the Czech Republic despite internal and external pressures to liberalize (2005). First, integration into the European economy may have provided important incentives for Eastern European states to pursue high welfare spending (Orenstein and Haas, 2005). This argument follows the compensation hypothesis, namely that in response to increased economic openness governments will raise social spending to protect citizens against possible growth in inequality and political instability (Cameron, 1978; Garrett, 2001). Second, prospective EU membership may have led national governments to embrace European norms and levels of social expenditure (Orenstein and Haas, 2005). In the case of economic and political reforms, the
influence of EU norms were clear. The 1993 Copenhagen Criteria of Accession outlined requirements for candidate countries to adjust national economies and build democratic institutions to bring them in accordance with existing EU member state practices (Potůček, 2009).

Although there was a less direct EU influence on social policy during the 1990s, the process of European integration still played a significant role in shaping domestic social policy discourse, agenda setting, instruments, and norms (Orenstein and Haas, 2005; Potůček, 2009). The influence of the EU over social policy in Eastern Europe only grew in 2002 with the implementation of the Lisbon Strategy, which recognized the importance of social cohesion and effective welfare states (Cerami, 2010; Potůček, 2009). While social policy goals continued to be secondary, in many respects, to economic and political integration objectives, the elevation of welfare concerns at the EU level encouraged Eastern European states to embrace the European Social Model. In the case of the Lisbon Strategy, candidate countries, such as the Czech Republic, were required to introduce policies focused on social activation and inclusion (Potůček, 2009). Additionally, European structural funds provided an important revenue source for some Czech welfare programs. For example, EU funds made up nearly a third of Czech active employment policy expenditures in 2006 (Potůček, 2009). Overall, the “Europe effect” helps to explain the maintenance of a strong welfare state in the Czech Republic despite the introduction of liberal reforms in some areas.

In sum, welfare development in the Czech Republic from the early post-communist transition until the global financial crisis can be characterized as one of social policy modernization, expansion, and liberalization. Much like Southern European welfare states, the late development of modern social protection systems in Eastern Europe followed a process of catch-up with the rest of Europe. This evolution follows a very different trajectory than other EU member states. Largely policymaking was driven by a desire to bring the Czech social spending and policies in line with
the welfare states of other EU members while at that same time trying to introduce neoliberal economic policy reforms. Social policy, in the first few years of independence entailed the introduction of comprehensive welfare coverage as an emergency measure to address the costs of sudden and drastic political and economic transitions (Horibayashi, 2006; Offe, 1993). As domestic and international pressures to liberalize the economy and the welfare state grew beginning in the 1990s, the universality of early social programs became more targeted and eligibility was tightened. Neoliberal concerns of cost containment, efficiency, and competition also came to the fore during this timeframe. However, while the Czech welfare state underwent clear liberalization reforms during the 1990s and 2000s, EU integration encouraged the government to embrace the European Social Model and try to bring social spending levels in line the rest of the EU (Cerami, 2010; Orenstein and Haas, 2005; Potůček 2009). Overall, by the start of the global financial crisis, social spending in the Czech had increased as a percentage of GDP and welfare programs had become more targeted and efficient than during the first few years of independence. Compared to its European neighbors, however, the Czech welfare state remained much smaller, thereby offering less protection against the negative effects of the global financial crisis.

**Pre-Crisis Political Support for Welfare Expansion and Liberalization**

An important feature of Czech social welfare changes during the 1990s and 2000s was the high degree of political consensus surrounding reform efforts. Within corporatist arrangements both at the central government and regional levels there was a considerable level of mutual trust and collaboration between trade union representatives, employees, and state officials (Potůček, 2009). The policymaking process of the Council for Social and Economic Agreement, for example, was fairly consensual between different stakeholders, not split by ideological or political divides
In addition to agreement between social partners, there was also considerable compromise between political parties during this timeframe. In the early years of post-communist transition, emergency social benefits were agreed upon as a necessary means to protect citizens against the potential harms of political and economic reform. As these systems became taxed by high unemployment and slow economic growth, arguments in favor of liberalization gained ground across parties. The targeting of universal programs, the tightening of eligibility, and reductions in social expenditures were seen by many on the left as necessary to maintain the welfare system and by those on the right as the best policy approach from a neoliberal ideological perspective (Müller-Rommel et al., 2004; Potůček, 2001).

Neoliberal thinking was particularly pronounced in the Czech Republic under the conservative government of Václav Klaus, who served as Prime Minister from 1993 to 1998. During his tenure in office, Prime Minister Klaus called for significant reductions in unemployment benefits and other social policy areas (Cerami, 2010). To highlight the influence that neoliberal thinking had on policy discourse during these years, there were some Czech government officials who claimed that unemployment was natural and beneficial for the country (Cerami, 2010). This suggested that unemployment was part of a normal functioning market and that state efforts to promote employment may even prove harmful to economic efficiency. However, while neoliberal thinking was clearly influential in economic and social reforms in the Czech Republic in the decades after post-communist transition, this did not result in a wholesale dismantling of the welfare state. At the same time that there were liberalization trends in some welfare areas, the Czech government also undertook efforts to increase social expenditures to bring them more in line with the generous levels of other EU member states. As the Europe Effect hypothesis suggests, prospective EU membership may have led parties on the left and right to embrace European norms and levels of
social expenditure (Cook, Orenstein, Rueschmeyer, 1999). This provides an important explanation for why the conservative Civic Democratic Party (ODS) party of Václav Klaus did not pursue greater welfare retrenchment despite its strong neoliberal ideological leanings.

Interestingly, social policy reforms and welfare expenditures in the Czech Republic were remarkably stable during the 1990s and 2000s, despite a transition from conservative to social-democratic government leadership (Potůček, 2009). Political divisions between parties on the left and right were fairly muted during this time as a strong consensus had formed over the trajectory and necessity of reforms. In fact, left/right political divisions and party ideology appear to have had very little influence over many of the social policy developments that occurred in the Czech Republic during this timeframe (Cerami, 2010; Cook, Orenstein, Rueschmeyer, 1999; Lipsmeyer, 2000; Orenstein and Haas, 2005). In terms of social spending, there were only minor fluctuations between the conservative ODS led government, which was in power from 1992 until 1997, and the social-democratic government led by the Czech Social Democratic Party (ČSSD) from 1998 until 2006 (Potůček, 2009). These trends suggest that social policy development in the Czech Republic during the pre-crisis period was not largely driven by party affiliation and ideology, but rather by dual pressures to liberalize aspects of the welfare state while at the same time increasing spending and expanding policies to bring them more in line with European standards.

**Czech Welfare State Post-crisis**

*Crisis Management Stimulus Measures (2008-2010)*

During its first two decades of independence, the Czech Republic undertook a number of macroeconomic structural reforms that led it to be one of the strongest economies in Eastern Europe by the start of the global financial crisis. Between 2003 and 2005 real GDP growth
averaged around 5% and GDP per capita grew from 73% to 80% of the EU average (European Commission, 2009). Unlike a number of its European neighbors, the Czech Republic was not immediately affected by the economic crisis and the long-term impact was more moderate overall (OECD, 2010c). This insulation from the effects of financial crisis was owed largely to sound fundamentals in the Czech economy including, limited reliance on foreign currency loans, high levels of bank capitalization, a flexible exchange rate, credible monetary policy, and the lack of major asset bubbles (IMF, 2012b). The exposure of the Czech banks to sub-prime securities at the start of the crisis was fairly negligible, which contributed to the resilience of the banking sector (European Parliament, 2009). The Czech government also maintained healthy spending levels with government debt at 27.1% of GDP in 2008 with a budget deficit of 2.2% for the same year (OECD, 2015c). However, despite being more modestly affected by the initial macroeconomic shock of the global crisis than many other EU members, the Czech Republic still faced weakened demand and a considerable loss of output. This led to higher levels of unemployment, more limited economic growth, and increasing social problems.

Since the Czech economy is largely export-oriented, there was a considerable slowdown of growth beginning in 2008, stemming from the collapse in global demand. In 2009, exports and industrial production each fell by 18% (European Commission, 2009). Although less reliant on international credit than many of its neighbors, the Czech Republic was still negatively affected by tightening credit availability and lower levels of foreign direct investment which resulted in a 7.4% reduction in investment in 2009 (European Commission, 2009). This had the effect of exacerbating economic decline and generating further social problems. By 2009, GDP had fallen

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15 Whereas foreign currency loans accounted for nearly 80% of private sector funding in some Eastern European countries, such as Estonia and Latvia, the Czech economy was far less reliant on external credit. In fact, foreign currency loans to the private sector only accounted for 10% of funding in the Czech Republic prior to the crisis making the country far less vulnerable to the post-crisis drop in international lending (European Commission 2009).
by nearly 5% and unemployment rose rapidly to 8% representing the biggest increase in a decade (Clasen et al., 2012). In response to these worsening social and economic conditions, the Czech government adopted two stimulus packages in 2009 worth CZK 75.6 billion ($US 3.91 billion) equaling over 2% of GDP (European Commission, 2009; UNDP, 2010).

Social protection increases were a sizeable component of these stimulus measures worth over CZK 18.4 billion ($US 950 million) and making up 24.34% of the overall package (UNDP, 2010). In addition to introducing measures aimed at addressing unemployment, these packages also lowered overall social security contribution requirements for citizens (European Commission, 2009). Despite the introduction of liberal welfare policies during the pre-crisis period, early crisis management responses by the Czech government reflected a strong corporatist approach. Such responses highlight the path dependent nature of the welfare system and legacies of Bismarckian social protection arrangements similar to those found in Continental systems. For example, in the aftermath of the crisis, the Czech government undertook tripartite deliberations with unions and employers in order to address concerns of slow growth and rising unemployment. One of the major labor market measures adopted by the Czech government, as a result of these negotiations, was a state subsidized short-time working scheme, closely resembling the German model (Clasen et al., 2012; Glassner and Keune, 2012; Heyes, 2011). This program is estimated to have benefitted nearly 2% of the Czech workforce in 2009 and served to stem the rise of unemployment (Hijzen and Venn, 2011; OECD, 2010c). This labor market response is in clear contrast to the measures undertaken by liberal welfare systems, such as the UK, which were far more reliant on market-based policies, rather than state negotiations with social partners (Heyes, 2011).

In 2009, the Czech government also introduced the ‘Education is a Chance’ and ‘Educate Yourself’ programs which offered financial incentives for employers to support training activities
for workers, particularly those on short-time work schemes, in order to improve employee skill sets and reduce the need for layoffs (Clasen et al., 2012; Heyes, 2011). These programs were funded largely through European structural funds indicating an important connection between European and domestic policymaking (Clasen et al., 2012). As with the short-time work schemes, these programs were established through tripartite negotiations and were quite similar to policies put in place by countries like Austria and Germany (Heyes, 2011). The Czech Republic also increased spending on job search support programs and active labor market policies to encourage higher levels of employment (Marchal et al., 2014).

As in the case of Continental systems, however, the emphasis on employment protection and social benefits for core workers, has also led to increased problems of dualization within the Czech workforce. Full-time regular employees were the clear beneficiaries of short-time work schemes and other measures aimed at protecting employment in the wake of the crisis (Clasen et al., 2012). By contrast, vulnerable workers, such as temporary workers, migrants, youth, who did not benefit from the same levels of employment protection were far harder hit by the crisis and faced much higher unemployment rates (Heyes, 2011). The policies adopted by the Czech government in response to the crisis further exacerbated this problem. While a number of measures were implemented to cushion the effects of the crisis on core workers, few measures were taken to support the long-term unemployed and a number of entitlement programs were even cut (Clasen et al., 2012). For example, while unemployment benefit rates were increased from 50 to 60% of earned salary for the first two months of unemployment, the length of eligibility was reduced by one month (European Commission, 2010b). In other words, while the short-term unemployed enjoyed better benefits, those who remained out of work for longer periods received far less generous social assistance (Clasen et al., 2012).
The Czech government also made greater allowances for the use of temporary contracts, in response to concerns over rising unemployment (Heyes, 2011). While these policies allowed many job seekers to return to the labor market, these workers did not enjoy the same level of employment protection or social benefits as their core worker counterparts. Additionally, although temporary contracts allowed for greater labor market flexibility, these measures were not accompanied by passive or active labor market policies which would allow low-skilled and part-time laborer to receive the training or support needed to transition into the full-time core workforce (Clasen et al., 2012; EIRO, 2010b). In sum, although the unemployment and labor market responses adopted by the Czech state alleviated joblessness in the short-term, they may have created further problems of dualization in the long-term (Clasen et al., 2012; Heyes, 2011).

While the fiscal stimulus packages adopted by the Czech government were quite large as a percentage of GDP, in overall value they were far smaller than those implemented by wealthier EU welfare systems, such as France, Germany the UK, and Sweden (European Parliament, 2009). The smaller size of the welfare state also meant that the ability of automatic stabilizers to protect citizens against economic downturn were weaker (Dolls et al., 2012). While data for the effects of automatic stabilizers in the Czech Republic is limited, available evidence indicates that, as in the case of Southern Europe, automatic stabilizers in Eastern Europe were far lower than in Northern and Central EU member states (Dolls et al., 2009). In the case of income absorption, automatic stabilizers across Eastern Europe ranged from 25% in Estonia to 32% in Slovenia, below the EU average of 38% and far lower than the effects in countries like Denmark at 56%, Belgium at 53%,

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16 To give perspective, automatic stabilizers in the Czech Republic closely parallel that of Poland and fall somewhere between those in Estonia on the low end and Slovenia on the high end (Eller 2009). In this regard, Poland serves as a useful proxy for Czech automatic stabilizer responses in the wake of the global financial crisis. However, it is useful to provide a range in order to understand that this is only an estimate and the true value lies somewhere between the given lower and upper bounds.
and Germany at 48% (Dolls et al., 2009; 2012). Automatic stabilizer responses were also similarly weak in labor markets across Eastern Europe, accounting for only 23% of the unemployment shock in Estonia, 33% in Poland, and 43% in Slovenia (Dolls et al., 2009, 2012). Again the effects of these automatic fiscal increases were lower throughout Eastern Europe than the EU average of 38% and considerably lower than some Central and Northern European states, such as 61% in Belgium, 62% in Germany, 68% in Sweden, and a staggering 82% in Denmark (Dolls et al., 2009, 2012).

As discussed in earlier chapters, these automatic stabilizers provide an essential buffer against the negative effects of economic downturn, particularly during crisis when consequences are sudden and severe, requiring a rapid response. While many welfare states in Northern and Central Europe were able to effectively lessen the negative consequences of the crisis in terms of unemployment and income loss, countries throughout Eastern Europe, such as the Czech Republic, had much more limited reactions. As a result, we see higher levels of unemployment and social instability in this region compared to other parts of Europe with more mature and comprehensive welfare systems. Overall, the weaker automatic stabilizer response meant that social protection measures to address the effects of the crisis in the Czech Republic had to be addressed through discretionary spending. This opened up the possibility for more political contestation over social spending and helps to explain the more pronounced political divisions that have emerged between parties on the left and right since the crisis began.

**Politics, Fiscal Discipline, and Austerity (2010 – Present)**

Although stimulus measures were initially put in place by the Czech government to limit the effects of the global economic crisis, fiscal consolidation and budgetary concerns became the
main focus of the state not long after these expansionary policies went into effect (European Central Bank, 2010). Despite a vote of no confidence, which saw a conservative ODS led government voted out of office in 2009 and a strong showing for the Social Democratic (ČSSD) party in 2010 national elections, center-right parties were able to maintain power during this time. These conservative led governments used the crisis as a justification to further liberalize aspects of the social welfare system and introduce a series of strict austerity measures (Clasen et al., 2012; Blum et al. 2014). In other words, by 2010, there was a clear shift in the Czech government’s response to the crisis from a strategy of stimulus to one of fiscal austerity (Richardson, 2010).

While the effects of the global economic crisis were less severe in the Czech Republic than in many other European countries, this event served as an excuse for rightwing governments in power to introduce further cuts to the social welfare system and implement fiscal discipline (Blum et al., 2014). The prevailing logic behind these austerity measures was the need to reduce public debt and deficit levels and promote individual responsibility by decreasing people’s reliance on the welfare system (Blum et al., 2014). The national budget for 2011, for example, included measures to reduce state spending by 10% of GDP, primarily through cuts to welfare and wages, as a means to reduce the budget deficit (European Commission, 2009; Pietras, 2009). The center-right ODS government also adopted a series of widespread public sector wage cuts and employment reductions, including a 2011 bill which reduced salaries by 10% (Glasner and Keune, 2012). Measures were also taken to freeze minimum wages between 2009 and 2011 (Glasner and Keune, 2012).

In addition to wage cuts and public sector layoffs, significant reductions were introduced by the conservative Czech government to a number of social policy areas. In the case of healthcare, the budget for the Ministry of Health was reduced by CZK 2 billion ($US 83 million) in 2010
representing a 30% decrease from 2008 funding levels (Mladovsky et al., 2012). Individual charges were also increased for health services, including the introduction of patient charges for hospitals and drug prescriptions. Inpatient fees, for example, were increased from CZK 60 to CZK 100 per day in 2012 (Mladovsky et al., 2012). The reimbursement rate of prescription drugs by national insurance funds was also cut by 7% between 2009 and 2011, resulting in higher patient co-payments (Mladovsky et al., 2012). Overall, these reductions in the Czech health care sector were among the most severe in Europe and similar to those taken by Southern European countries, who were much harder hit by the crisis, such as Greece and Spain (Euractiv, 2014).

The conservative led Czech government also introduced a number of reductions in the area of family support benefits. In August 2010, for example, the government introduced (Act No. 347/2010 Coll.) which reduced spending by 1.3 billion CZK ($US 53.6 million) on family policies (Blum et al., 2014). The ODS led government also adopted legislation that limited parental leave, by reducing maternity and paternity allowances and eligibility duration (Richardson, 2010). Overall, these social reforms were clearly informed by neoliberal thinking as reductions in benefits and greater reliance on private care were promoted as a means to increase individual responsibility and introduce market alternatives to state support (Blum et al., 2014).

**The Crisis and Growing Political Divisions**

The shift from emergency stimulus response to austerity in the Czech Republic reflects the post-crisis political composition that evolved within the country. National political configurations have become increasingly intense as divisions between parties on the left and right have grown over how best to address social and economic concerns. Whereas the period from independence until the start of the financial crisis was largely defined by the unifying goal of EU accession,
which guided policymaking toward liberal economic reforms and the development of a welfare state based upon the European Social Model, the financial crisis seriously challenged this political consensus (Economist, 2010b). Slow economic recovery from the global recession, credited by some as a result of austerity measures, led to growing political dissent between the main political parties, mass protests on behalf of citizens, and the rise of new parties on the political extremes.

Although stimulus packages were implemented by the Czech government in 2009, as a necessary emergency response to the crisis, it was not long before the conservative ODS government, led by Prime Minister Mirek Topolanek, began to pursue a pro-austerity agenda. Mr. Topolanek was appointed by Czech President Vaclav Klaus in 2007, and like Mr. Klaus harbored strong neoliberal ideological leanings. As the crisis progressed, plans were made to introduce sweeping public finance reforms and social spending cuts to reduce government expenditures (Radio Czech, 2007; Reuters, 2007). However, these plans were limited by strong opposition in Parliament led by the Social Democrats (ČSSD), and faced considerable resistance from trade unions and civil society members who came out against the legislation (Radio Czech, 2007). Opposition to Prime Minister Topolanek’s government culminated in a 2009 vote of no confidence led by the ČSSD, which saw the ousting of the conservative ruling coalition and the establishment of a temporary non-partisan placeholder government under the leadership of economist Jan Fischer. The vote of no confidence highlighted a growing division between the main political parties on the left and right. This dissent over competing visions, between advocates of austerity and proponents of stimulus, of how best to address the crisis became even clearer in the June 2010 general election.

In the build up to the national election, Czech Social Democrats ran on a platform which proposed to protect the welfare state from cuts and maintain popular social support benefits, such as the pay-as-you-go pension system (Reuters, 2010a). Jiri Paroubek, the head of the ČSSD who
led the call for a vote of no confidence against the ODS, made several pledges to raise taxes on the wealthy and businesses as a means to expand social welfare services (New York Times 2009a; Reuters 2010b; Clasen et. al 2012). In order to lower the national debt, the ČSSD proposed raising government revenue by CZK 70 billion ($US 2.2 billion) through a combination of higher taxes on the wealthy and an increase in the corporate tax rate from 19 to 21 percent (Reuters, 2010a). By contrast the conservative ODS ran on a party platform emphasizing budgetary responsibility and fiscal discipline as a means to prevent a debt crisis similar to that faced by the Greek government (Reuters, 2010b). The ODS’ goal of cutting the national deficit from 5.9% in 2010 to 3% of GDP by 2012, as recommended by the EU, would be achieved by reducing social spending and privatizing aspects of the health care and pension services. (Reuters, 2010b). The election therefore underscored the very contrasting beliefs that the main Czech parties on the left and right had about appropriate long-term government responses to the economic crisis.

Despite receiving more votes than any other party, at 22.1% of the electorate, the Social Democratic ČSSD was unable to secure a parliamentary majority (Reuters, 2010b). This failure to form a government represented a considerable blow to left-wing parties and the ČSSD in particular. Instead, with 20.2% of the vote, the ODS was able to successfully form a center-right governing coalition, along with the newly established conservative TOP 09 party and the centrist Public Affairs party (Reuters, 2010b). Petr Nečas, the head of the new ODS government, made clear his neoliberal policy agenda by stating that his administration would focus on promoting, “a government of budget responsibility” and arguing that the policies of left leaning parties would lead the Czech state into bankruptcy (Dvorakova and Stroleny, 2012; Reuters, 2010b).

Although successful in forming a ruling coalition, based upon a liberal policy agenda of fiscal responsibility, the center-right government would face an increasingly volatile political
environment. Upon taking office, the new ruling coalition sought to fulfill its campaign promises by implementing substantial budgetary cuts and austerity measures. The 2011 budget, for example, included a number of provisions which would reduce government spending by over CZK 35 billion ($US 1.4 billion) through a series of tax increases, welfare state reductions, and a large 10% cut to public sector wages (Contiguglia, 2011; Dvorakova and Stroleny, 2012). In order to implement these austerity measures, in October 2010, the ODS and its allies declared a legislative state of emergency, which allowed them to bypass opposition in Parliament and forgo negotiations with social partners (Freedom House 2013). These legislative actions, along with a growing public dissatisfaction with austerity, led to mass protests in Prague with tens of thousands taking to the streets (BBC, 2015e; EPSU, 2011). The CMKOS trade union confederation helped to organize these anti-austerity rallies against welfare and public wage cuts arguing that no proper social dialogue had occurred around these measures (Dvorakova and Stroleny, 2012; EPSU, 2011).

Political resistance also increased in October 2010, when the Social Democrats won control of the Senate in mid-term elections allowing them to obstruct the proposed austerity measures (BBC, 2015e). In addition the facing a veto by the ČSSD controlled Senate, the conservatives were also dealt a large set back in 2011 when the Constitutional Court declared that the emergency legislative procedures taken by the government were unconstitutional, thereby preventing the proposed austerity packages from going forward (Freedom House, 2013). Despite extensive political hostility, however, in June 2011 the OSD was able to successfully push through liberal welfare reforms, in areas such as health care and unemployment policies, in the lower house (Freedom House, 2013). In November 2011, the lower house was also able to implement major changes to the pensions, which partially privatized the system (Freedom House, 2013).
These austerity measures were again met with substantial backlash by the public. In April 2012, some of the largest protests since the fall of communism took place in Prague with eighty to ninety thousand citizens coming out against continued austerity and recent corruption scandals (Guardian, 2012c). These protests were part of ongoing mass resistance organized by trade unions and civil society groups who opposed the social spending cuts and liberal policies of the center-right government. The ODS government under Prime Minister Nečas, lost a tremendous amount of popularity in the wake of these demonstrations. The Nečas’ government faced two parliamentary votes of no confidence in April and November 2012, and narrowly avoided losing power in both (Freedom House, 2013). Political opposition also gained momentum in the October 2012 elections as the ČSSD was able to secure further seats in Senate (Freedom House, 2013; Wall Street Journal, 2012d). With public scrutiny at an all-time high, in June 2013, Prime Minister Nečas resigned amid a corruption scandal leading to the establishment of a temporary placeholder government (BBC, 2015e).

Taking advantage of public dissatisfaction with sustained fiscal discipline, loss of faith in conservative party leadership, and the longest economic recession on record in the Czech Republic, the ČSSD was able to gain control of the government in the October 2013 general election and form a ruling coalition (Bloomberg, 2013b; BBC, 2015e). The outcome of the 2013 national election represented a clear shift to the left in Czech politics. Upon taking office the ČSSD, along with its allies, came to a policy agreement which would increase the minimum wage, offer tax breaks to families with children, ensure that pensions were tied to inflation rates, and eliminate healthcare fees put in place by the ODS (Economist, 2013). The policy agreement also reversed many of the neoliberal reforms made by the Nečas government to the pension system, including
abolishing policies which allowed retirement savings to be diverted from state programs into private funds (Economist, 2013).

The ascendance of the political left in the Czech Republic, beginning in 2013, marked a significant turning point in the social spending agenda within the country. Whereas conservative ODS led governments under Prime Ministers Topolanek and Nečas pursued fiscal discipline and implemented broad cuts to a number of social programs, the ČSSD under Prime Minister Bohuslav Sobotka adopted a series of social spending increases. The budget approved for 2015, for example, included provisions to increase spending on social services by CZK 450 million ($US 18.66 million) bringing to an end a series of budgetary cuts to state welfare (Radio Prague, 2014). In addition to overall social spending increases, the budget included specific measures to increase pensions by an average of CZK 200 ($US 8.25), which although modest was five times higher than the previous ODS budgetary increase (Radio Prague, 2014). Public sector employee wages were also increased by 3.5% to 5% and tax breaks were introduced for families with children along with cuts to value added taxes on prescription drugs (Radio Prague, 2014). Reflecting the desire to promote generous labor market and welfare policies, the ČSSD also dedicated the largest share of funding in the entire budget to the Ministry of Labour and Social Affairs (Radio Prague, 2014). These policies were met with resistance by parties on the right who claimed that such plans would cause significant problems for state finances. Miroslav Kalousek, a prominent member of the TOP 09 party claimed that under the 2015 budget investment would suffer and criticized the high level of state spending (Radio Prague, 2014). These sharp political divisions between mainstream parties in the aftermath of the crisis in many ways stand in contrast to the longstanding accord between the left and right over social and economic reforms that prevailed in the period before the crisis. This change is reflected in the statistically significant effect that political party composition of
government has had on social spending outcomes in the post-crisis period, an influence which was not present during the 1990s and early to mid-2000s.

In addition to the sharp contrast between the positions of the main parties on the left and right over social spending responses, there has also been a significant rise of new alternative parties in Czech politics since the start of the crisis. The rise of these new parties represents a higher degree of polarization domestically and a disillusionment amongst the public with traditional party leadership. This change is somewhat surprising as the political party system in the Czech Republic had been one of the most stable in Eastern Europe after the fall of communism. Compared with countries in the region, such as Poland and Slovakia, public support for mainstream parties in the Czech Republic before the crisis remained relatively constant (Havlík, 2015; Spáč, 2013). Whereas the two mainstream parties in Czech politics, the ČSSD and ODS, collectively received more than two thirds of the vote share in the 2006 general election, by the 2010 elections their vote share was only 42% percent and had dropped to a mere 28% in the 2013 elections (Havlík, 2015). These election results represent a considerable loss of public support and a largescale change of the party system configuration in the Czech Republic.

The 2010 elections saw the introduction of two new political parties, TOP 09 and Public Affairs, into the Czech Parliament. TOP 09, a liberal-conservative party, emerged in 2009 and capitalized on the economic crisis to call for austerity measures and fiscal discipline in order to avoid a Greek-style debt crisis. Although established in 2001 as a regional party, Public Affairs also emerged on the national political scene during the 2010 elections, running on a strong anti-establishment and anti-corruption campaign platform (Havlík, 2015). Both upstart parties were able to take advantage of the ongoing economic crisis to make significant gains in Parliamentary elections receiving jointly nearly one third of the vote (Havlík, 2015). Not only did the 2010
election represent a significant victory in terms of public support for both TOP 09 and Public Affairs, but it also gave these parties considerable political power as they each ended up serving as the main partners in the ODS conservative ruling coalition (Economist, 2010b; Euractiv, 2010; Havlík, 2015).

The 2013 elections also saw the introduction of two new anti-establishment populist parties, the Action of Dissatisfied Citizens (ANO) and the Eurosceptic Dawn of Direct Democracy (Usvít), into the Czech Parliament (Economist, 2013). The newly formed ANO party clearly benefitted from this election receiving 23.5% of the seats in Parliament and becoming a partner in the ruling coalition led by the ČSSD (Havlík, 2015). Collectively, ANO along with Usvít and TOP 09 accounted for 43.5% of the seats in Parliament after the 2013 election (Havlík, 2015). While a presence in Czech politics since independence, the far-left KSČM communist party also gained in support receiving 16.5% of the seats in Parliament in 2013, up from 13% in 2010 (Havlík, 2015).

The 2010 and 2013 elections, therefore, represented a considerable change in the Czech political landscape and a growing fragmentation of the party system, with voters shifting away from traditional mainstream parties in favor of new parties.

Along with growing political divides between parties on the center-left and right, there has also been a rise of the extreme far-right in Czech politics. Since 2013, several new far-right parties, including Usvít, Freedom and Direct Democracy, and the Bloc against Islam, have formed with strong anti-immigration, anti-Islamic, and Eurosceptic platforms. The rise of these parties has also coincided with growing anti-immigrant sentiment amongst some members of the public with protests being held in Prague and other parts of the country, although these rallies have remained fairly small in size (BBC, 2015e; Independent, 2015c; Radio Prague, 2016). While the power of these extremist parties in Parliament has been limited, the growth of the far-right in Czech politics
still represents a troubling turn toward the political extremes as economic downturn has persisted and social problems have continued in the country.

The high level of political instability in domestic Czech politics and the sharp divide between parties on the left and right since the start of the crisis has also had important implications at the European level. The debate between the merits of austerity versus stimulus, for example, came to the fore in 2009 when conservative Czech Prime Minister Topolanek, who held the rotating position as President of the European Union at the time, denounced US President Barack Obama’s stimulus plan as, “a way to hell” which would “undermine the stability of the global financial market.” (New York Times, 2009b). These provocative comments were met by discomfort by many EU leaders who did not believe these comments reflected the European consensus and could potentially undermine solidarity around regional and global efforts to address the financial crisis (New York Times, 2009b). The neoliberal stance of the ODS, therefore, had important implications at the European level, shedding light on the differences that various countries held as to the costs and benefits of stimulus measures as a strategy to address the crisis. Despite the relatively small size of the Czech economy, as the acting head of EU, Topolanek was granted an outsized voice in European policymaking, which added further support to those members favoring austerity, such as Germany and the UK. German officials for, example, echoed concerns that the American stimulus program would lead to financial instability and argued that EU countries must pursue a path of fiscal discipline instead (New York Times, 2009).

Prime Minister Topolanek’s statements not only highlighted divisions between the national policy positions of EU member states, but also the growing divide between political parties on the left and the right within countries. His comments, for example, were not only met with resistance by left-wing parties within the Czech Republic, but also by other left leaning parties in other
countries such as Germany, despite the pro-austerity position that the German government had adopted. Martin Schulz, a leading German Social Democratic official, for example, criticized the Czech Prime Minister’s comments arguing that they were undiplomatic and did not reflect the position of the EU as a whole (New York Times, 2009). Topolánek’s controversial statements, and the reactions they evoked, laid bare the political separation that had developed across parties on the left and the right throughout Europe since the start of the crisis. Unlike the cross party neoliberal consensus that had prevailed during the time before the crisis, the period after the crisis began is characterized by increased political polarization over social and economic policymaking.

The increasing volatility of the Czech political party system since the start of the crisis has also played out in European Parliamentary elections. Whereas mainstream parties dominated the 2009 European Parliamentary elections with the ODS receiving 31.45% of the vote and the ČSSD coming in second place with 22.38%, each would face significant losses in the 2014 elections (European Parliament, 2009). The 2014 European Parliamentary elections represented a big victory for newly formed parties as ANO came in first with 16.13% of the vote followed in second place by a conservative liberal coalition between of TOP 09 and STAN, a right-leaning party focused on local issues (European Parliament, 2014). ČSSD came in third place with 14.17% of the vote, representing an 8.21% loss of the vote share compared with its 2009 results (European Parliament, 2014). The far-left KSČM communist party came in fourth place 10.98% of the vote (European Parliament, 2014). Finally, the ODS came in a distant sixth place with a mere 7.67% of the vote, representing a remarkable 23.78% drop from its 2009 level of support (European Parliament, 2014). Overall, the 2014 European Parliamentary election outcomes paralleled the loss of support for mainstream political parties domestically within the Czech Republic, a notable
change from the high degree of stability that existed in the party system prior to the crisis (Brusis, 2004; Havlík, 2015; Spáč, 2013).

In addition to a loss of support for mainstream parties in lieu of newly formed alternatives, the 2014 European Parliamentary elections also saw an uptick in anti-EU sentiment among Czech parties. In the build up to the 2014 European Parliamentary elections, the center-right ODS made a rejection of the Euro as the national currency a main theme of their campaign (Economist, 2014b). Even the pro-European ČSSD rejected EU-inspired austerity plans, indicating that the party was less willing to accept the necessity of EU inspired economic reforms (Economist, 2014b). The far-right Usvít party ran on a Eurosceptic platform and even advocated for the closing of European borders to immigrants (Economist, 2014b). The conservative No to Brussels - National Democracy (National Democracy) party, established in 2014 from the earlier Law and Justice Party, ran a provocative anti-EU campaign ad which was banned from Czech state television due to, among other things, its perceived anti-Semitic content (Economist, 2014c). Although many of these parties, for example Usvít and National Democracy, did not gain seats in the European Parliament their presence indicates a clear Euroscepticism within Czech politics (Economist, 2014b, 2014c; Hornát, 2014). The strong anti-EU sentiment and rise of new Czech political parties largely stem from the ongoing effects of the economic crisis. The foundation for much of the political conflict has been competing visions for how to address continued economic downturn and increasing social problems pitting advocates of austerity against opponents who favor more fiscal stimulus to ensure social protection.
Conclusion

While sharing some of the key institutional features of its Continental European neighbors, the Czech welfare system represents a distinct combination of social protection arrangements characteristic of Eastern European history and development. The welfare system in the Czech Republic, like many of other Eastern European states, has a strong corporatist tradition, based on Bismarckian social protection policies, similar to those found in the Continental welfare regime type. This system was present in the Czech Republic prior to Communist control of the country and continues to have important legacies in present day social protection measures, including pension systems, unemployment benefits, and labor market policies (Deacon, 1997; Potůček, 2009; Żukowski, 2009). However, unlike Continental European regimes, the Czech welfare state exhibits more universalistic tendencies reflecting the high degree of coverage that existed under the Soviet system (Aidukaite, 2011; Potůček, 2009). Another important common feature of the Eastern European welfare model is its historical post-communist transition toward liberal social and economic model beginning in the early 1990s. After the collapse of the Soviet Union, considerable efforts were made to liberalize various aspects Eastern European welfare states which coincided with broader economic restructuring, although this did not constitute a wholesale dismantling of the welfare state or the convergence toward a liberal welfare regime type (Aidukaite, 2011; Potůček, 2001, 2009; Saxonberg and Sirovátka, 2009).

The social protection in the Czech Republic, therefore, encapsulates a unique mix of welfare arrangements which incorporates certain features of other regimes, while constituting a distinct Eastern European welfare type (Arts and Gelissen, 2002; Aidukaite 2009a, 2009b, 2011; Cerami, 2010; Cerami and Vanhuysse, 2009; Fenger, 2007; Golinowska et al., 2009). Generally, social protection is characterized by a high degree of coverage, low levels of social spending and
benefits, and residual liberal tendencies, particularly in recent years (Aidukaite, 2011). The period after the transition to democracy until the crisis was largely defined by a desire to liberalize the Czech economy and modernize the welfare system by bringing it closer in line with the more developed social institutions of other EU member states. Welfare reforms during this period from independence until the start of the financial crisis, were largely driven by the unifying goals of integration into the global economy and accession into the European Union, which led to considerable political stability and consensus between parties over reform trajectories.

This consensus is exemplified by the fact that welfare reforms and social spending remained relatively stable in the Czech Republic during the 1990s and 2000s, even as control of government shifted between conservative and social-democratic leadership (Potůček, 2009). In other words, political party divisions and ideological differences appeared to have had very little influence over social policy during this time (Cook, Orenstein, Cerami 2010; Rueschmeyer, 1999; Lipsmeyer, 2000; Orenstein and Haas, 2005). Instead, social reform was guided by liberal pressures to make the welfare state more efficient on the one hand, and the belief that social policies and expenditures needed to be brought more in line with the European Social Model on the other hand.

The economic crisis, however, led to considerable political instability and polarization between parties in the Czech Republic over social and economic policy responses. Within a short-time after adopting emergency stimulus measures, the conservative ODS led coalition government switched tactics and embraced a series of neoliberal inspired fiscal cuts and welfare retrenchment policies. Whereas liberal reforms were perceived as a necessary adjustment by left-leaning parties to ensure the long-term viability of the welfare state in the pre-crisis period, given the severity of the economic downturn and concerns that austerity would only prolong the effects of the recession, the conservative policies of the ODS were met with considerable resistance by the left in the wake
of the financial crisis. The pro-austerity agenda of the ODS and its conservative allies, was met with strong opposition in Parliament by the ČSSD who not only worked to block proposed cutbacks to social spending, but organized several votes of no confidence, successfully ousting ODS governments in 2009 and again in 2013. By contrast Czech Social Democrats, upon taking office in 2013, pursued an alternative policy agenda which saw the expansion of social welfare services and a reversal of many of the cuts implemented by the ODS (Clasen et al, 2012; New York Times, 2009; Reuters, 2010b). The ascendance of the political left in the Czech Republic in 2013, marked a significant turning point for social spending and highlighted the considerable ideological differences that informed the decision-making of parties on both ends of the political spectrum. In short, the economic crisis appears to have ended the political agreement that had formed between parties in the pre-crisis period around social and economic policies, leading to a period of greater political conflict. The foundation of this conflict was a clear division between advocates of austerity and proponents of stimulus, which led to split between mainstream parties.

In addition to growing differences between mainstream political parties, as the economic crisis persisted more and more citizens began turning to newly formed alternative parties, which resulted in a splintering of the Czech party system. This was a remarkable change in domestic political dynamics, as the Czech party system had been one of the most stable in Eastern Europe after the fall of communism (Havlík, 2015; Spáč, 2013). These newly established parties have been highly effective in drawing support away from the two main parties, the ODS and ČSSD, who saw their collective share of the popular vote drop from 77.5% of Parliamentary seats in 2006 to only 33% in 2013 (Havlík, 2015). In fact, the ODS went from 81 seats in Parliament in 2006, the highest share of any party, to only 16 seats in 2012, the second lowest of any party (Havlík, 2015). In addition to gaining public support the newly formed Public Affairs, TOP 09, and ANO all served
as coalition partners in government, and the latter two parties came in first in the 2014 European Parliamentary elections indicating that these parties wielded considerable political power.

Slow recovery from the worst recession since independence also led to popular unrest over austerity measures as tens of thousands of citizens took part in mass protests in Prague and other cities around the country. These demonstrations indicated an increased politicization of social and economic policies and a disenchantment with political leadership. The post-crisis period also saw a radicalization of public opinion with anti-EU and anti-immigrant sentiments gaining ground (BBC, 2015e; Economist, 2014c; Independent, 2015c; Radio Prague, 2016). Coinciding with these more extreme sentiments among some citizens has been the rise of far-right political parties, such as Usvít, Freedom and Direct Democracy, and the Bloc against Islam. Although overall support for these parties has remained minimal, their formation represents an increase of political extremes into Czech politics. In contrast to the decades after independence, the post-crisis period represents a time of intense political contestation and ideological division within the Czech Republic.

Changing domestic political dynamics in the Czech Republic have also contributed to the European austerity debate. While holding the rotating Presidency of the EU, the center-right ODS party acted as a strong advocate of neoliberal principles and pushed the necessity of fiscal austerity. These arguments in the early phases of the crisis contributed to a growing coalition of actors at the European level who favored austerity measures as a regional response to the crisis and saw continued stimulus as potential destabilizing to financial markets and economic growth potential. While in office from 2006 to 2013 the center-right ODS government remained a strong proponent of austerity, embracing European calls for fiscal discipline and debt reduction. The ascendance of the social democratic ČSSD in 2013, however, marked a turning point in domestic policies toward greater stimulus and social spending. This leftward shift may potentially undermine the austerity
coalition, spearheaded by countries like Germany and the UK, which has driven EU policymaking since the beginning of the crisis. Additionally, the 2014 European Parliamentary elections saw the induction of several new Czech political parties into the body, indicating a loss of influence for the ODS and ČSSD at the European level. This change in the political makeup of the Czech party system and its representation in the European Parliament may make achieving political consensus over future social and economic policy responses more difficult to achieve at home and regionally.

In sum, there has been a high degree of conflict and instability in Czech politics since the onset of the crisis that had not been seen in the decades preceding this event. There has been a growing divide between mainstream parties as the pre-crisis consensus that existed over social and economic reform trajectories has fallen apart. The conservative ODS party has embraced strict austerity measures and macroeconomic fiscal adjustments as means to reduce debt. By contrast, the center-left ČSSD has taken a stronger stance against this neoliberal policy approach. Instead the Social Democrats have advocated for stimulus spending and social policy expansion to offset the costs of the recession and encourage economic growth. At the same time that an ideological divide has grown between the ODS and ČSSD, there has also been a high level of support for newly established political parties which have undercut the traditional party system in the Czech Republic. This political sea change has had important implications both domestically and at the European level and has the potential to significantly change the policy agenda for the entire region. The foundation of this political fracturing lies in the wider debate between austerity and stimulus that has arisen in the wake of the financial crisis. Sharp ideological differences have led parties on the left and right to pursue very different policy responses to the economic downturn which has further fueled the politicization of crisis management strategies. The new political dynamic which
have arisen in domestic Czech politics will have important implications for future social and economic policy developments both domestically and at the European level.
Chapter 10: Conclusion

The global financial crisis that began in 2008 was the worst economic disaster that the world had seen since the 1930s. The Great Recession resulted in the loss of trillions of dollars in GDP and millions of jobs around the globe. With the crisis, national governments were faced with limited economic growth prospects and worsening social conditions. This event represented an unprecedented and massive shock to the entire global financial system which not only challenged the resiliency of the welfare state, but undermined the very theories, policies, and practices upon which pre-crisis social and economic agreements rested. The magnitude of the crisis and its subsequent impact on political, economic, and social dynamics, therefore, cannot be understated. This final chapter reviews the large-scale changes in social spending, political contestation, and economic decision-making that occurred in the wake of the crisis. This section identifies how the variables which shape social spending changed from the pre- to post-crisis periods. In doing so, it will reexamine the theoretical reasoning as to why the crisis so profoundly altered the politics of social spending. A brief review of the case studies presented in this dissertation will help shed light on broader shifts that are occurring across advanced welfare states. Finally, this chapter will investigate some of the possible long-term consequences of this crisis on political dynamics, policymaking, social outcomes, and economic thinking going forward.

Scope and Scale of the Crisis

In 2012, Mark Adelson, former chief credit officer of Standard & Poor’s, estimated total global losses from the crisis to be as large as $15 trillion (Wall Street Journal, 2012a). Economists at the Federal Reserve Bank of Dallas gave a far more pessimistic assessment estimating that, within the first two years of the crisis, the loss in the US alone was approximately $6 to $14 trillion,
equivalent to an average loss of $50,000 to $120,000 for every American household (Atkinson et al., 2013). According to the 2014 World Development Report, between 2007 and 2012 nearly 30 million people lost their jobs bringing the number of unemployed globally to around 200 million (World Bank, 2014). Within the EU the average unemployment rate rose to 9.5% between 2008 and 2014 and averaged 10.3% within Eurozone countries during the same time (OECD, 2015).

While the true social and economic costs of the crisis are difficult to attain, it quickly becomes clear that in terms of scope and the scale, the Great Recession was the worst financial disaster of the modern era. As my research has shown, the severity of this acute financial crisis fundamentally reshaped the political and institutional variables that drive social spending outcomes across advanced welfare states resulting in post-crisis dynamics which are far different from those that existed in the pre-crisis period. These changes will have a profound influence on global social and economic policymaking in the years to come.

Crisis as a Catalyst for Change

The global financial crisis served as a powerful catalyst for political change and shifts in social spending dynamics across countries. In the wake of this event, intense political conflict has arisen over economic regulations, social redistribution, and the role of welfare states in providing effective policy responses to the crisis (Starke et al., 2012). This highly politicized post-crisis policymaking environment is in stark contrast to the depoliticized nature of pre-crisis social and economic decision-making. There are several theoretical reasons for why the crisis led to such a dramatic change in the dynamics of cross-national social spending. First, the crisis acted as a powerful shock to the global economy resulting in financial collapse, economic recession, rising unemployment, and increased social inequality. The severity and immediacy of problems faced by
states created enormous pressure for national governments to provide substantial and immediate crisis management responses to limit the negative distributional effects on society. This event, therefore, disrupted the existing social spending patterns, as evidenced by the large increase in social spending adopted by nearly all advanced states at the start of the crisis in the form of fiscal stimulus packages. Theoretically, acute financial crises have been identified by numerous scholars as important variables in generating institutional reforms and policy changes. Whereas under normal economic conditions there is often social policy continuity with little change in spending levels, the severe consequences of economic crises can lead to drastic changes in welfare spending and policies as states react to worsening conditions (Baumgartner and Jones, 1993; Keeler, 1993; Kwon, 2001; Palier, 2010).

Although national governments pursued reactionary social spending increases at the start of the crisis, which helped to address some of the immediate problems faced by both citizens and markets, this fiscal stimulus led to higher public debt and deficit levels. Growing budgetary concerns as the crisis wore on have created long-term pressures for governments to adopt fiscal discipline. As a result, post-crisis conditions of austerity and budgetary constraint have forced political actors to make difficult choices about which groups benefit from social policy changes giving rise to sharp distributional conflicts (Vis et al., 2011). In other words, the crisis not only elevated social and economic concerns to the forefront of the political agenda, but it also generated considerable debates over domestic welfare responses resulting in a more politicized policymaking environment (Singer, 2011).

Second, the global financial crisis seriously challenged the logic of market fundamentalism and the need for more limited state intervention, which had been ascendant before the crisis. The crisis exposed the weakness of existing neoliberal policies and regulations, thereby undermining
the pre-crisis consensus that had formed around these policies. As a result, since the beginning of the crisis there have been much more pronounced ideological divisions between political parties on the left and the right who promote very different visions for how best to address the crisis. Whereas conservative parties have largely embraced the need for fiscal discipline, macroeconomic reforms, and further liberalization, many parties on the left have begun to raise concerns that such policies will only prolong the crisis and lead to deteriorating social conditions. The return of Social Democratic and other left leaning parties to power, in countries like France and Sweden, signals a growing anti-austerity sentiment among some European citizens and represents a strengthening of opposition to recovery policies, advocated by states such as Germany and the UK, which focus strictly on fiscal discipline. In states harder hit by long-term economic downturn, such as Greece and Spain, opposition has become even more pronounced with far-left and far-right populist parties gaining support on anti-austerity and anti-EU sentiments. This political conflict has grown since the start of the crisis and reflects deeper ideological divisions as to the legitimacy and effectiveness of austerity versus fiscal stimulus spending. The crisis has, therefore, ushered in a new period of ideological conflict over the role of the welfare state. At the heart of this political divisiveness and polarization is a serious debate over the merits and cost of austerity. This ideological dispute has played a central role in shaping social and economic policies in post-crisis Europe.

Finally, the economic crisis created political opportunities for opposition parties to gain power by claiming that responsibility for the financial collapse fell onto ruling governments. The success of opposition parties is demonstrated by the political sea change that occurred in the EU after the crisis. By 2011, nearly half of the Eurozone governments were either voted out of office or forced to end their terms early (Deutsche Bank, 2012). The clear winners of this political shift were center-right political parties who were swept into power in the first few years of the crisis. By 2012, 19
of the 27 EU government were controlled by center-right parties, including 11 of the 17 Eurozone members states (Deutsche Bank, 2012). This political context has had important consequences for social and economic recovery policies in Europe, as a coalition of conservative governments, led by countries including the UK and Germany, were able to promote a crisis management response based upon a logic of fiscal discipline and austerity. In other words, the neoliberal ideological beliefs held by ruling conservative political parties in the early stages of the crisis have had an important impact defining social and economic policy strategies at the European level. Such policies have led to subsequent political backlash by parties on the left who have increasingly opposed strict austerity. These policies have also led to the rise of populist parties on the political extremes who have been able to capitalize on growing of anti-austerity sentiment amongst the public. The political landscape of Europe which was altered in the wake of the crisis, therefore, not only legitimized liberal recovery policies, but has also defined the lines of political conflict as the crisis has worn on. The next sections will examine the specific ways in which the political consensus over social and economic policymaking has changed as a result of the global economic crisis and the implications of this ideological shift.

**Pre-Crisis Social and Economic Consensus**

As we have seen, both at the European level and domestically, the pre-crisis period of the 1990s until the mid-2000s was characterized by a high degree of political consensus over economic and social policy trajectories (Hendrik et al., 2004). The foundation for this agreement was a strong neoliberal ideological belief in the primacy of free markets and the secondary supporting role of the welfare state in promoting economic growth. Whereas historically European states were associated with generous social spending and the expansion of welfare programs, beginning in the
1990s there was a notable reduction in welfare spending across states and the liberalization of social policies, such as health care and pensions. Neoliberal policies promoted by the EU, IMF, and World Bank elites gained incredible influence over social and economic policymaking. During this time, government leaders across parties began to subscribe to the belief that the welfare state should be more limited in scope and serve primarily in a market supporting capacity (Begg, Draxler, and Mortensen, 2008; Rodrik, 2011; Scharpf and Schmidt, 2000). These liberal policy prescriptions were also encouraged by EU institutions whose main focus was on economic integration and increased competition, (Leschke and Jepsen, 2012; Hemerijck, 2013; Scharpf, 2002). The influence of neoliberal thinking in EU policymaking in the pre-crisis period is evidenced by the negative correlation that EU membership had on social spending during this time (see Table 9, Chapter 3).

Perhaps the most surprising aspect of prevailing neoliberal thinking during this time is the high degree to which parties across the political spectrum incorporated these beliefs into their policy platforms. In fact, social spending during the pre-crisis period was largely depoliticized as parties on both the left and right in a number of countries introduced a variety of market based welfare reforms. Using quantitative content analysis of party platforms from the Comparative Manifesto Project database, along with surveys on party positions on a left-right scale, Hendrik et al. found that during the 1990s and early 2000s both center and left-leaning parties moved further to the right (2004). In fact, in the late 1990s, when social democratic parties were in control of a majority of governments in Europe, they pursued far less interventionist policies than in the past and seemed far more willing to accept EU liberal economic goals (Hendrik et al., 2004). The prevailing neoliberal belief that fiscal consolidation and market-based social investment strategies would result in higher levels of economic growth and well-being for citizens led many left-leaning
parties, traditionally in favor of generous social spending, to accept welfare retrenchment policies. This depoliticization of liberal welfare reforms in the pre-crisis period can be seen across all of the case studies analyzed in this research.

In the case of the UK, by the mid-1990s, the New Labor party under Prime Minister Tony Blair began to rethink its commitment to a well-funded welfare state and instead pursued a series of neoliberal inspired social investment policies which focused on productivity and economic growth (Labour Party, 1994, 1997). Upon taking office in 1997, New Labour pursued many of the conservative social policies of the previous Conservative led government, including fiscal discipline, welfare cuts, and the introduction of market-based social policies, such as the partial privatization of pension schemes (Hodson and Mabbett, 2009; Taylor-Gooby, 2001). In the case of Germany, liberal Hartz reforms to the labor market and welfare system were introduced by the center-left Social Democratic Party and Green Party coalition government and were based upon earlier reforms proposed by center-right parties (CEPS, 2014; Zohlnhöfer and Herweg, 2012,). Even in Sweden, a traditional haven for social democratic belief in the necessity of generous social spending, liberal welfare reforms were embraced not only by parties on the right, but also by left-wing leaders, such as Göran Persson, who served as the Swedish Social Democratic Prime Minister from 1996 until 2006 (Haffert and Mehrtens, 2015). Finally, in both Spain and the Czech Republic dual pressures to both liberalize their economies, promote competition and efficiency, and bring social spending levels in line with other EU member states led to considerable consensus between parties on the left and right over social spending decisions (Cook, Orenstein, Rueschmeyer, 1999; Cerami, 2010; León and Pavolini, 2014; Moreno; 2000, Müller-Rommel et al., 2004; Orenstein and Haas, 2005; Potůček, 2009).
These cross-national trends suggest that welfare reforms and social spending expenditures during the pre-crisis timeframe were not largely driven by differences in political party control of government. In fact, social spending levels within states often remained remarkably stable, during this time, even as national governments changed leadership between conservative and liberal parties. This social spending stability can be explained by the fact that left/right political divisions and party ideological differences were minimal as a strong agreement over the necessity of liberal reforms was reached. Quantitative analysis of this time period confirms these findings as neither electoral system variations nor differences in political party control of government were statistically significant in affecting overall social spending levels (see Table 11, Chapter 3). Evidence from the five case studies reviewed, each representative of a larger number of states with similar social protection arrangements, emphasizes that the depoliticized nature of social spending was widespread across countries during this time. Welfare state spending in the pre-crisis period was, therefore, broadly defined by low levels of political divisions between parties and the ascendance of neoliberal ideological belief in social and economic policymaking.

**Post-Crisis Political Divisions and Polarization**

In stark contrast with the period preceding the global economic downturn, there has been incredible polarization and political contestation over social and economic policies in the wake of the global financial crisis. Between mainstream political parties on the left and right, there have been growing divisions over the role of the welfare state and the continued value of neoliberal policies in addressing the crisis. In Sweden, for example, whereas the Social Democrats introduced a number of liberal reforms, which sought to limit the size and scope of the welfare state, during their tenure in office from 1996 until 2006, since the crisis began they have campaigned on a
platform emphasizing the need for increased social spending and welfare expansion (Bergh and Erlingsson, 2009; Haffert and Mehrten, 2015; Reuters, 2014b). Sweden’s Social Democrats have also been far more vocal in their opposition to center-right policies of fiscal discipline and welfare retrenchment in the wake of the crisis. Even within countries, such as Germany, where political contestation has been less volatile, left-wing political parties, including the center-left SPD, have moved further to the left and drawn clearer distinctions between their own platform and that of their conservative counterparts (ECFR, 2012). While the center-right CDU has been a leader in promoting austerity measures in Germany and abroad, since the crisis the SPD, along with other left-wing parties, including the Green Party and Liberal Party, have challenged this approach calling for greater spending on social programs and placing an emphasis on growth over strict austerity (Armingeon and Baccaro, 2015; Hübner, 2013). The same is true in the UK, where the Labour Party, who had embraced neoliberal inspired Third Way policies in the 1990s and 2000s, has moved further to the left opposing welfare cuts and calling for limited austerity measures (Labour, 2015a, 2015b). By contrast, the Conservatives in the UK have continued their support for neoliberal strategies introducing the largest reductions to the British welfare state since the development of the modern welfare state at the end of World War II (Gardiner et al., 2010; New York Times, 2010a).

In addition to the split between traditional parties, there has also been a splintering of the political party system in many countries and the rise of newly formed anti-establishment parties. This includes the introduction of the far-left and far-right parties into national elections in some states. Spain, for example, has seen a high degree of political volatility since the start of the crisis including popular unrest in the streets and a considerable loss of support among mainstream center-left PSOE and center-right PP parties, who saw their joint share of the national vote decline nearly
10% between 2008 and 2011 (Funke et al., 2015). In 2014, the populist far-left Podemos party was formed running on a platform to end austerity measures, restructure Spanish debt, and increase social spending (Junor, 2015; Open Europe, 2014; Schofield and Caballero, 2015). According to a 2014 public opinion poll, Podemos was supported by 27.7% of the population, compared with 26.2% for the center-left PSOE and 20.7% for the ruling conservative PP party, representing the first time that a new party had come ahead of the two mainstream parties (Junor, 2015).

The two main parties in the Czech Republic also saw a considerable loss of public support since the start of the crisis. Whereas the ČSSD and ODS, collectively received more than two thirds of the vote share in the 2006 general election, by the 2010 elections their vote share had shrunk to 42% percent and dropped even further by the 2013 elections to a mere 28% of the vote (Havlík, 2015). These election results represent a considerable loss of public support for mainstream parties and a largescale change of the party system within the Czech Republic. Riding the wave of public discontent over political responses to the crisis, newly formed parties including TOP 09, Public Affairs, and ANO were all able to make significant gains in national elections and serve as ruling coalition partners (Euractiv, 2010; Economist, 2010b, 2013; Havlík, 2015). The rise of new alternative parties in Spanish and Czech politics represents a higher degree of polarization domestically and a disillusionment amongst the public with traditional party leadership. The success of these populist parties has led to a significant reordering of the political landscape within each country.

The political shifts which have occurred across Europe are indicative of the larger tensions that have grown post-crisis between advocates and opponents of austerity over the types of social and economic policies which should be pursued by national governments. As each of the five cases analyzed in this dissertation indicate, the shifting political composition of national governments
has been highly influential in determining the types of social policies that states have adopted. Variations in political party control of government in the post-crisis period have been a key factor in explaining divergent cross-national welfare spending patterns. This is confirmed by the statistically significant correlation that political parties have had on social spending levels since the onset of the global financial crisis (see Table 11, Chapter 3).

Debates over whether austerity or stimulus strategies are more effective means to address the ongoing economic crisis have not only led to increasing divisions between domestic political parties, but also between states and actors at the European level. In many regards, conservative parties were the clear electoral winners across the EU after the global financial crisis. By 2012, 19 of the 27 heads of government in EU countries were from center-right, including 11 of the 17 Eurozone members states (Deutsche Bank, 2012). This strong political representation allowed conservative governments in countries, such as Germany and the UK, to establish a center-right coalition in Europe, which helped to legitimize pro-austerity social and economic recovery strategies (EUCE, 2013; Regan 2012). At the start of the crisis, support for this more conservative oriented approach was also advocated for by the ECB and European Commission. These neoliberal policy responses are evident in the strict debt and deficit requirements present in the 2012 Fiscal Compact and the structural reforms and austerity measures which were conditions of EU bailout funds for Ireland, Greece, Portugal, and Spain (European Commission, 2012a, 2012b). However, whereas conservative parties and beliefs have dominated EU crisis management responses, strong opposition by left leaning parties has grown in Europe. Left-wing governments in countries such as Greece, Spain, France, and Sweden have begun to question the orthodoxy of neoliberal austerity measures and social spending reductions. Political divisions have become particularly pronounced in Southern Europe as widespread public discontent over austerity measures has led to the rise of
radical populist parties, such as Syriza in Greece and Podemos in Spain. Overall, social and economic policy decisions have become highly politicized since the start of the crisis resulting in a weakening of support for traditional center-left and center-right parties and the rise of parties on the far-left and far-right. Worsening social conditions, slow economic recovery, and growing discontent with fiscal discipline have helped to strengthen these radical political parties. The result is a far more politically volatile environment in Europe.

Radicalization of the European political landscape has not only led to inter-state conflict over social and economic policies, but also had an important impact on EU institutions themselves. The 2014 European Parliamentary elections, for example, saw considerable gains by far-left and far-right Eurosceptic and anti-austerity parties over traditional centrist political parties. The anti-EU UK Independence Party, for example, won 27.5% of the vote receiving more support than either the Conservative or Labor mainstream political parties (BBC, 2014a). In France, the far-right National Front party received nearly 25% of the vote, almost a third of France’s seats in the legislative body (France-Politique, 2014). Spain’s Podemos party garnered nearly 8% of the vote and five seats in the European Parliament, displacing several traditional parties (BBC, 2014b). Results from the 2014 elections came as a considerable shock to the European establishment, as they represented the first time in history that anti-EU parties had gained seats in the European Parliament (Reuters, 2014a).

This new political map of Europe, with its high degree of polarization, may be indicative of a period of prolonged conflict over social spending and greater instability as agreement between parties may become more difficult to achieve. The foundation of this disagreement has been a serious reevaluation of neoliberal policy orthodoxy and fierce political debates over the advantages and costs of austerity. Whereas the pre-crisis period saw widespread support for deregulation,
market liberalization, and welfare reductions across political parties, since the start of the crisis these policies have come under serious attack and subsequent economic and social policies have been subject to greater political conflict. Politics, therefore, have been of paramount importance in explaining the divergent social spending trajectories of states in the wake of the financial crisis. This said there have been other important intervening variables namely, welfare state arrangements and EU institutions and policies, which have mediated the severity of political conflict. The next section will explore the important role that each variable has played and examine some of the competing theories and expectations for post-crisis welfare outcomes.

The Welfare State, Crisis, and Political Conflict

Welfare state institutions have been correlated, even in the pre-crisis period, with different social spending outcomes across countries, Continental and Nordic states, for instance, have been associated with much higher levels of social spending than their Liberal, Southern European, and Eastern European counterparts. In the immediate aftermath of the global financial crisis, these social protection institutions played an important role in defining the types of stimulus response measures that national governments adopted. The degree to which these systems were able to buffer citizens against the effects of the crisis, particularly the strength of automatic stabilizer responses, also helped to mediate long-term political conflict over social spending. Although government leaders and EU officials saw the immediate need to introduce stimulus measures, in order to limit the social and economic costs of the crisis, the size and content of national fiscal responses differed considerably (OECD, 2010a).

Whereas wealthier welfare states were able to introduce generous stimulus packages, other countries with smaller social protection system were unable to provide the same levels of social
support and economic investment. Austria, Germany, Sweden, and Finland, for example, all adopted generous stimulus measures equivalent to over 3-4% of GDP (European Commission, 2009a; Leschke and Jepsen, 2012, 291). By contrast, Hungary, with its smaller economy and less well funded welfare system, was unable to increase social spending at all in response to the crisis economic crash (European Commission, 2009a; Leschke and Jepsen 2012, 291). Overall, stimulus responses were notably lower in Southern and Eastern Europe than in other EU member states. This shows that even at the early stages of the crisis there was considerable variation in national crisis responses that corresponded with the size and generosity of domestic welfare systems.

Beyond the sheer size of stimulus responses, the types of policies that national governments adopted to address the crisis were largely in line with the welfare systems present in each state. Germany, Spain, and the Czech Republic, for example, all adopted stimulus measures which were negotiated between the state and social partners (Chung and Thewissen, 2011; Clasen et al., 2012; Glassner and Keune, 2012; Heyes, 2011; Möller ,2010). This strategy reflects the corporatist nature of the welfare system in each country. Short-time work schemes introduced in the Czech Republic and Germany, for instance, were predicated on an agreement that firms would limit layoffs if workers would agree to reduced wages. The state played an important role by providing tax breaks and other incentives for firms to maintain employment levels. National governments also offered social support to workers with reduced wages and the unemployed. These tripartite negotiations are in stark contrast to the UK crisis management response, which relied more heavily on market-based policies, rather than direct government negotiations with firms and employee associations (Chung and Thewissen, 2011). Rather than short-time working schemes, the British government pursued activation policies, including job search initiatives and training programs, designed to get unemployed laborers back to work. This response was in keeping with the
expectations of the UK’s liberal welfare system. Finally, reflecting the generosity and universal nature of the Nordic welfare state, Sweden’s stimulus response was much larger than many other EU members (Chung and Thewissen, 2011). This stimulus package was composed of policies which sought to promote full employment, provide income protection, and offer substantial unemployment benefits for citizens (Swedish Prime Minister’s Office, 2008). The government also played a much larger role in providing social support and protection in Sweden than in other member states, such as the UK.

Overall, the composition of stimulus packages and the varying degrees of state intervention after the crisis point to path dependencies based upon different welfare system legacies. The social protection arrangements found within states, in other words, were influential in defining the kinds of early crisis response strategies adopted by national governments. This is important because even though liberal reforms were adopted across welfare states during the pre-crisis period, the stimulus responses of national governments did not follow a uniform liberal strategy. This is contrary to the expectations of theorists who argue that international pressures and European market integration would lead to greater cross-national convergence of social policies in line with a liberal welfare model (Clayton and Pontusson, 1998; Fulcher, 1994; Gilbert, 2002; Goodman and Pauly, 1993; Korpi, 2003; Korpi and Palme, 1998; Mishra, 1999). In fact, not only has some research provided empirical evidence for the existence of distinct welfare families, but these studies find that the differences between systems have become more pronounced overtime rather than less so, despite increased globalization and European integration (Castles and Obinger, 2008; Dolls et al., 2009 2010, 2012). Post-crisis stimulus policies offer a powerful counter-argument to the idea of liberal convergence. The divergent nature of the initial post-crisis responses across countries highlights the continued importance that welfare state differences play in defining social spending outcomes.
Finally, the size of the automatic stabilizer response in different welfare systems played an important role in limiting or exacerbating political differences in the wake of the financial crisis. For example, the automatic stabilizer response in Nordic and Continental welfare systems was much larger after the crisis than that of other EU members. Due to the reflexive nature of these mechanisms, social spending was increased without the need for discretionary budgetary decisions to be made. As a result, there was less political debate over social spending increases in these welfare systems (Cohen and Follette, 2000; Dolls et al., 2010). In other words, political questions about social policy expansion versus retrenchment were more limited in larger welfare states and partisan conflict lessened (Starke et al., 2012).

On the other hand, states with less generous welfare systems had much weaker automatic stabilizer responses to the crisis. In Spain, for example, automatic stabilizers accounted for only 28% of income shock absorption and 38% of the unemployment shock absorption (Dolls et al., 2012). By comparison, automatic stabilizers accounted for 53% of income shock absorption in Belgium and 56% in Denmark (Dolls et al., 2009, 2012). Automatic stabilizers also accounted for 68% of the unemployment shock absorption in Sweden and a remarkable 82% in Denmark (Dolls et al., 2009, 2012). Whereas countries in Northern and Central Europe were able to limit unemployment and income loss through automatic social spending increases, many member states in Southern and Eastern Europe had much more limited responses. As a result, we see far higher levels of unemployment and social instability in these regions. The weaker automatic stabilizer response in these welfare systems meant that social protection measures had to be addressed through discretionary spending decisions. This has allowed for more political contestation over social spending and helps to explain the high degree of political conflict and polarization that we have seen in many of these countries, including the rise of far-left and far-right parties.
While an important intervening variable, the differences in welfare systems alone cannot explain the divergent social spending outcomes we see across states after the crisis. For example, although Sweden is a classic example of the Nordic welfare model, known for its high levels of social spending and universal coverage, as the crisis wore on the government pursued a series of welfare cuts and liberal reforms. This included considerable reductions to social programs and the tightening of eligibility for unemployment benefits and sick pay (The Local, 2014). To put these reforms into perspective, since the start of the crisis, Sweden has gone the furthest in reducing the size of its welfare state than any other Scandinavian country (The Local, 2014). A key explanation for these social spending reductions, which seem counterintuitive to a Nordic welfare response, is the center-right coalition which held control of government in Sweden during this time. Under the conservative leadership of Prime Minister Fredrik Reinfeldt, the Swedish government pursued a long-term economic recovery strategy of fiscal discipline and social spending reductions, rather than fiscal stimulus. In other words, despite the generous nature of the Swedish welfare system, conservative party control of government created pressure for social spending reductions and welfare liberalization as the crisis wore on. While this does not necessarily indicate a convergence of the Swedish model toward a liberal welfare system, it does speak to the powerful influence that political parties play in shaping social spending outcomes, even within one of the most universal and well-funded welfare states in Europe.

Political party control of government also helps to explain the significant differences in social spending responses of states with similar welfare systems. For instance, at the same time that the US adopted substantial increases in social spending and implemented one of the most significant expansions of the American healthcare system in decades, the UK undertook a series of extensive budget cuts and welfare state reductions (Economist, 2013; ILO, 2011; OECD, 2009).
Political parties have been the key driver of these social spending differences between these two cases since the onset of the crisis. The 2008 US national elections, saw the center-left Democratic Party under the leadership of President Barack Obama come into power. President Obama ran on a political platform which emphasized government spending increases to encourage economic growth, promote job creation, and increase social support (New York Times, 2012). By contrast, the 2010 national elections in the UK saw the success of the Conservative Party, under the leadership of David Cameron, who ran on a platform stressing the need for fiscal discipline and welfare reductions (New York Times, 2010). As a consequence of these electoral results, while the US continued its stimulus spending efforts, by 2010 the UK began to introduce some of the most significant cuts to the British welfare system since the end of World War II (New York Times, 2010). Differences between conservative and liberal party control of government in the UK and the US help to explain why each state pursued such dissimilar long-term crisis management responses, despite having similar welfare systems in place. These political differences also highlight a larger debate that has occurred in the wake of the global financial crisis. This debate has centered on the role of the welfare state in supporting recovery efforts and the extent and timing of fiscal discipline, placing advocates of immediate austerity against supporters of sustained stimulus and incremental long-term budgetary cuts. The effects of political party control of government on social spending outcomes, therefore, provides an important counter-argument to theories which argue that welfare reforms are strictly path dependent and insulated from political pressures for change (Myles and Pierson, 2001; Pierson, 1996, 2001).
The European Effect

EU influence has been another important intervening variable in explaining social spending variations across Europe both before and after the crisis. Although EU institutions and policies have exercised very different effects in each timeframe. While member states maintain governing authority over social policy areas, decision-making is embedded within a larger European institutional context. In the years building up to the crisis, EU membership was positively correlated with welfare state retrenchment (See Table 9, Chapter 3). This effect corresponded with greater European economic integration and a liberal emphasis on competition, efficiency, and increased market freedom (Leschke and Jepsen, 2012). Growing EU authority over regional economic matters, including Maastricht convergence criteria and the formation of the Eurozone, not only reduced the capacity of member states to determine their own economic policies, but limited the ability for national governments to define their social goals (Hemerijck, 2013; Scharpf, 2002). The spillover effects of economic integration into social policy areas led to greater welfare liberalization and social spending limits during this time.

Since the start of the global financial crisis, however, EU membership has no longer been statistically correlated with social spending reductions (See Table 9 Chapter 3). Eurozone membership, in fact, has even been correlated with social spending increases. This change can be explained by fact that during the early stages of the crisis it became clear that EU institutions and member states would need to undertake strong and rapid social and economic policy actions to limit the effects of the global downturn. The European Commission spearheaded this response by introducing the 2008 European Economic Recovery Plan which proposed a clear guide for coordinated action at the national and EU levels (European Commission, 2008). In many respects, this recovery plan provided an authoritative framework for member states to coordinate national
stimulus packages (European Commission, 2009b). In addition, the EU dedicated €200 billion in structural funds, equal to 1.5% of EU GDP, toward regional recovery efforts (European Commission, 2009b). The recovery plan, therefore, provided EU resources and recommendations in support of national efforts to revitalize domestic economies, address unemployment, and protect socially vulnerable groups. However, while EU membership has not been correlated with social spending reductions since the start of the crisis, specific policies put in place have put downward pressure on states to lower welfare spending. Most notably the 2012 Fiscal Compact, which created binding rules for all Eurozone members to adopt balance budget rules and lower structural deficits, has once again put pressure on members to reduce welfare state expenditures (European Commission, 2012a, 2012b).

While EU institutions and policies have been important in shaping social welfare spending outcomes across member states, these variables alone cannot explain the variation in social spending throughout the region. In fact, a great deal of the changes which have occurred at the European level tie into important shifts that have occurred in the political map of Europe. Whereas liberal policy recommendations were fairly widely accepted by member states in the past, the post-crisis environment has given rise to sharp political debates over government spending and social welfare provisions. In other words, unlike the depoliticized pre-crisis atmosphere in which liberal policy tools were introduced across states with little resistance, social spending in the post-crisis period has been subject to much sharper political divisions both domestically and at the EU level.

The EU has been an important voice in the political debate over austerity that has played out across Europe particularly among policy elites. It has also been subject to many of the same political changes that have occurred since the onset of the crisis. On the one hand, the EU serves as the originator and enforcer of much of the region’s austerity policies, for example, the 2012
Fiscal Compact and bailout agreement conditions for countries including Greece, Ireland, and Portugal. Yet on several occasions EU institutions have also broken with fiscal policy conservative hardliners. The ECB’s decision, for example, to begin a program of Eurozone government bond purchasing in 2015 led to tensions with pro-austerity government officials in countries, such as Germany and the UK, who opposed quantitative easing measures to buy public debt (Wall Street Journal, 2015b). While acknowledging the importance of budgetary restraint, as acting heads of the European Commission both José Manuel Barroso and Jean-Claude Juncker each noted the limits of austerity and the need for policies focusing on growth strategies and a relaxing of fiscal discipline (RTE, 2014; Spiegel, 2013a). In his assessment of the austerity agenda, President Barroso cited a lack of “political and social support" for fiscal discipline and a need to pursue policies which had, "a stronger emphasis on growth" (Spiegel, 2013a). This statement reflects the growing anti-austerity shifts in European politics, and speaks to the ways in which political constraints have affected the decision-making and policies of EU institutions. To fully understand post-crisis social and economic outcomes in Europe, therefore, it is vital to acknowledge the powerful role that political and ideological changes have played in influencing the policies and practices of both member states and EU institutions.

Conclusion

Since the start of the global financial crisis there has been growing policy uncertainty and increasing political polarization over the legitimacy of different social and economic recovery strategies. These debates have affected the social spending of different states and help to explain the variation in welfare responses seen across EU members. The crisis was a key trigger for the transformation and polarization of the political landscape in Europe and the subsequent policy
debates which have arisen over the viability of austerity measures versus fiscal stimulus. In many respects, this political sea change is an affirmation of recent research which argues that political polarization becomes far more pronounced after severe financial shocks (Funke et al., 2015; Stanig, 2013). The victory of center-right parties in the immediate wake of the financial crisis allowed fiscally conservative crisis management policies to be promoted as the most reasonable and effective response to the recession by countries, including Germany and the UK. In other words, the ascendance of conservative parties in European politics post-crisis resulted in a strong coalition in favor of pro-austerity crisis management strategies. Domestically, conservative party control of government has been correlated with social spending reductions, indicating the acceptance of liberal austerity beliefs. By contrast, states with left-leaning governments have largely not pursued the same degree of welfare reductions seen in center-right led states. This marks an important change from the pre-crisis period where shifts in political party leadership were not associated with changes in social spending levels. Politically driven decisions to encourage fiscal discipline at the European level have also had the effect of lowering levels of member state social spending. EU policies informed by politically conservative liberal ideology, such as the 2012 Fiscal Compact, placed pressure on governments to reduce debt and deficit levels and introduce cuts to the welfare state. These cuts have been particularly pronounced in Southern Europe where welfare responses have been weaker and the subsequent effects of the crisis have been greater. Within this region we have seen some of the most politically contentious debates between parties and between national governments and EU bodies. As the crisis has worn on, Southern European states have seen the rise of parties on the far-left and far-right in domestic politics. This radicalization of the political party system provides support for claims that lower
levels of social spending are strongly associated with increased political polarization (Lindqvist and Östling, 2010; Swank and Betz, 2003).

The political divisions over social and economic policies represent an important end to the pre-crisis neoliberal consensus which governed social and economic policies. Since the start of the crisis, political parties on the left and right have pursued very different policy agendas emphasizing stimulus and austerity respectively. As a result of these growing divisions, political party control of government has become significantly correlated with social spending outcomes since the start of the crisis, an effect that was not present in the pre-crisis period (see Table 11, Chapter 3). At the same time that conservative parties have embraced fiscal discipline and welfare cuts, parties on the left have moved further away from neoliberal orthodoxy and have called for social spending increases and limits to austerity. Beyond reshaping national and regional political dynamics, this polarization has had important consequences for policymaking throughout Europe as consensus has been more difficult to achieve. At a time when agreement is most needed, the high levels of polarization present in European politics may hinder long term recovery efforts (Lindqvist and Östling, 2010). Contentious debates between the far-left Greek government and its European creditors, for example, have led to considerable instability in EU markets. This political and economic instability threatens to prolong the crisis. Growing anti-austerity and anti-EU sentiment have also placed limits on the ability of national governments and EU institutions to develop effective economic recovery strategies for the region as differences between actors have widened.

Finally, in addition to the powerful transformative effect that the crisis has had on politics and policies both domestically and at the European level, this event also powerfully undermined the prevailing neoliberal paradigm. In the short-term, this led to a number of institutional and policy changes. For example, in 2009, the European Commission released the de Larosière report,
which highlighted failures of risk management and a lack of regulation of financial markets as the main problems underlying the crisis (de Larosière, 2009). The report facilitated EU institutional and financial regulatory reform designed to strengthen economic oversight at the European level. New banking regulations, including the 2008 Deposit Guarantee Scheme and 2009 Capital Requirement Directive, were introduced (Quaglia, 2012). Basel 2 revisions provided new rules on capital requirements and deposits (Quaglia, 2012). New investment fund, credit agency, and accounting regulations were introduced. The European Commission proposed directives which established three European Supervisory Authorities, including the European Banking Authority, tasked with ensuring the financial supervision of European markets and the adoption of common standards across member states (Quaglia, 2012). These changes represent a significant shift in the European economic regulatory approach, according greater financial and banking oversight to EU authorities and a move away from pre-crisis neoliberal policies and practices which emphasized market deregulation and limited government and EU supervision.

In the long-term, political challenges to the neoliberal agenda may lead to more significant paradigmatic changes in social and economic policymaking. During the 1990s, European welfare states, for example, were identified as possible hindrances to economic growth and competition. Neoliberal influenced assessments, such as the 1992 OECD job report, concluded that generous welfare benefits led to higher labor market costs, which contributed to rising unemployment and slow growth (OECD, 1994, 1997). These neoliberal beliefs inspired successive policies which encouraged welfare liberalization and social spending reductions across many European welfare states (Hemerijck, 2013; Scharpf, 2002). While the 2000s saw the elevation of social concerns at the European level, through adoption of the Lisbon Treaty, these issues remained secondary to the primary goal of economic integration. Reflecting prevailing liberal beliefs, the composition of the
Lisbon Treaty seemed to suggest that social objectives would be inherently advanced through economic success and that the priority should be to focus strictly on economic growth and job creation (Dieckhoff and Gallie, 2007; Zeitlin, 2008). Social policy reforms during this time, therefore, continued to represent the dominant neoliberal approach which advocated for the individualization, decentralization, and the privatization of welfare services (Leschke and Jepsen, 2012).

Since the start of the crisis, however, there has been a reevaluation of social and economic policies. While austerity has been the prevailing long-term crisis management approach in Europe, there have been growing critiques about the effectiveness of this neoliberal inspired approach. Although EU institutions, along with their IMF counterparts, were instrumental in establishing austerity measures as a requirement for bailout funds, these institutions have since acknowledged their failure to account for the negative economic impact and social consequences that such harsh fiscal reductions might have on indebted member states (Bloomberg, 2013a; IMF, 2013; Washington Post, 2013). A 2012 Working Paper by the IMF, for instance, indicated that introducing rapid cuts to government spending and social policies in countries with shrinking GDPs could lead to deeper recession and damage long-term growth prospects, without generating the desired budgetary savings (IMF, 2012a). The European Commission has also cited the limits of economic austerity measures and the possible threats that rapid and sustained government expenditure cuts can have on social, political, and economic stability (RTE, 2014; Spiegel, 2013a). In fact, austerity measures have been cited as the cause for the slow economic recovery in Europe and continued problems with high unemployment and low consumer demand (ECFR, 2012; European Parliament, 2013).
In addition to questions about the effectiveness of austerity measures, there has also been an emerging focus on the negative effects of social inequality on economic growth and a renewed call for greater welfare state interventions. A 2014 IMF report, for example, identifies the negative effect that growing social inequality has on health, education, investment, political stability, and economic growth (IMF, 2014). A similar 2014 OECD report identifies a correlation between rising income inequality and low levels of economic growth (OECD, 2014b). A 2015 OECD report on economic policy reforms urges governments to pursue policies which not only focus on growth, but incorporate mechanisms for greater redistribution to help reduce rising inequality (OECD, 2015a). These include investment in workforce training for labor market outsiders and increased social benefits (OECD, 2015a). This marks a significant about face from the OECD labor market reports of the 1990s which blamed social institutions and redistributive mechanisms for slowing economic growth. These new reports speak to the importance of social spending and welfare policies as means through which the state can encourage growth and limit social inequality. This renewed focus on the welfare state as a means to promote economic growth and reduce social inequality has gained acceptance by many left leaning parties in Europe. For example, this belief was the centerpiece of Sweden’s Social Democrats in the most recent national election (Bloomberg, 2014b).

Historically acute financial crisis have produced broader changes in economic paradigms and shifts in thinking about the significance of social welfare. The Great Depression of the 1930s and destruction of the Second World War saw the rise of Keynesian economic theories and the development of the modern welfare state. The Stagflation and Oil Crisis of the late 1970s saw a weakening of support for Keynesian beliefs and a turn toward neoliberal theories, which by the end of the Cold War had become the prevailing economic paradigm worldwide. As a result, there
was a strong trend of cross-national welfare liberalization at this time and the implementation of social investment policies, rather than passive benefit provisions. While the 2008 global economic crisis may not signal an end to the neoliberal paradigm, it has called into question many of its underlying assumptions, resulting in intense political conflict over market regulations, social redistribution, and the role of the state in providing effective policy responses to crisis. Within the new post-crisis context, the importance of the welfare state and its relationship with the market is in the process of being reevaluated. Rather than a hindrance to economic prosperity, social protection systems may in fact come to be perceived as the core foundation through which economic success is achieved. This is true not only for the market supporting role that the welfare state plays through social investment, but also the vital redistributive role it has in reducing social inequality. Growing social inequality and worsening economic conditions are threats to future prosperity across countries. Welfare systems may, therefore, be a key mechanism through which national governments can address these pressing concerns. Understanding what drives social spending outcomes across states in the post-crisis period is, therefore, critical to improving social and economic well-being throughout Europe and the globe.
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## Appendix I. Variable Measures

### Dependent Variables

<table>
<thead>
<tr>
<th>Dependent Variables</th>
<th>Description/Significance</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government social spending, % of GDP</td>
<td>This is a measure of overall social spending generosity.</td>
<td></td>
</tr>
<tr>
<td>Social Spending on Unemployment</td>
<td>Benefits include unemployment compensation, severance pay, and early retirement for labor market reasons. This is a measure of social spending generosity.</td>
<td></td>
</tr>
<tr>
<td>Social Spending on Old Age Benefits</td>
<td>Benefits include pensions, early retirement funds, residential care, and other in-cash or in-kind benefit.</td>
<td></td>
</tr>
<tr>
<td>Social Spending on Health Provisions</td>
<td>Benefits include public health expenditures on in- and out-patient care, medical goods, and prevention.</td>
<td>OECD Database</td>
</tr>
<tr>
<td>Social Spending on Family services</td>
<td>Benefits include child allowances and credits, childcare support, income support during leave, and sole parent payment.</td>
<td></td>
</tr>
</tbody>
</table>
| Social Spending on Active Labor Market Policies (ALMPs) | ALMP benefits include all social expenditure (other than education) which is aimed at the improvement of the beneficiaries’ prospect of finding gainful employment or to otherwise increase their earnings capacity.  
This category includes spending on public employment services and administration, labor market training, special programs for youth when in transition from school to work, labor market programs to provide or promote employment for unemployed and other persons (excluding young and disabled persons) and special programs for the disabled. |                 |
<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Description/Significance</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU Membership</td>
<td>This is a dummy measurement, with 0 denoting a non-EU country and 1 denoting an EU member country.</td>
<td>European Commission</td>
</tr>
<tr>
<td>EMU Membership</td>
<td>This is a dummy measurement, with 0 denoting no EMU membership and 1 denoting EMU membership.</td>
<td>European Commission</td>
</tr>
<tr>
<td>Europe 2020</td>
<td>This is a dummy measurement with 0 non-participation in the Europe 2020 legislation and 1 denoting participation.</td>
<td>European Commission</td>
</tr>
<tr>
<td>2012 Fiscal Compact</td>
<td>This is a dummy measurement with 0 non-participation in the 2012 Fiscal Compact legislation and 1 denoting participation.</td>
<td>European Commission</td>
</tr>
<tr>
<td>Electoral system</td>
<td>This includes three variables related to electoral system types: Majoritarian, Mixed, and Proportional Representation</td>
<td>World Bank Database of Political Institutions</td>
</tr>
<tr>
<td>PR government composition</td>
<td>This is a dummy measurement with 0 no presence of a strong Christian Democratic Party and 1 denoting the strong presence of a Christian Democratic Party in government. A threshold of voter share above 15% is used as a measure of strong Christian Democratic presence</td>
<td>Esping-Andersen, 1990, 1999; Dolls et al., 2009, 2010, 2012; Castles and Obinger, 2008</td>
</tr>
</tbody>
</table>
**Control Variables**

The model includes a fairly standard set of control variables that have been argued in the literature to affect government spending:

<table>
<thead>
<tr>
<th>Control Variables</th>
<th>Description/Significance</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per Capita (US$)</td>
<td>This measures real GDP per capita (in US$) within a country.</td>
<td>OECD Social Expenditure Database</td>
</tr>
<tr>
<td>Economic openness (exports plus imports divided by output)</td>
<td>This accounts for the hypothesis that exposure to international markets leads to more demand for spending (Cameron 1978; Garrett 1998; Rodrik 1999).</td>
<td></td>
</tr>
<tr>
<td>Female labor force participation</td>
<td>This variable accounts for the hypothesis that female entry into the labor market will tend to create new demand for social services (Huber and Stephens 2000).</td>
<td></td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>The positive effect of unemployment on unemployment spending is obvious (although it need not affect other spending, and can even reduce it with tight budget constraints). Although it can be argued that unemployment is an important shock, we are not interested in the effect of the sheer size of the unemployed population. Instead, we want to know if shocks affect the generosity of spending. Including this control ensure “conservative” estimates.</td>
<td>OECD Social Expenditure Database</td>
</tr>
<tr>
<td>Dependent population size</td>
<td>Measures % population (under 15 years of age) and (over 65 years of age) to control for the effects that the size of non-working population may have on public demands for increased social spending. The size of the retired population, for example, may create pressure for increased social spending in a number of areas such as pensions (Iversen and Soskice 2010).</td>
<td></td>
</tr>
<tr>
<td>Voter turnout</td>
<td>Measure the number of individuals that cast a ballot during an election as a share of the population of voting age - generally the population aged 18 or more - as available from administrative records of member countries.</td>
<td></td>
</tr>
</tbody>
</table>
Appendix II. Regression Tables

### Total Social Spending as % GDP

```
xtreg gvt_ss_total gdp_per econ_open female_labor unemp_pop pop_under_15 pop_over_65 vturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed pr continental nordic eastern southern cd_strength nordic_interact continental_interact eastern_interact southern_interact cd_strong_interact, re
```

| Variable    | Coef. | Std. Err. | z     | P>|z|  | [95% Conf. Interval] |
|-------------|-------|-----------|-------|------|----------------------|
| gdp_per     | 3.299 | 0.001144  | -0.000071 |
| econ_open   | 0.000004 | 0.000146  | -2.95 | 0.003 | 0.0000144 | 0.000071 |
| female_labor| -0.000021 | 0.000009  | 3.05  | 0.002 | -0.026344 | -0.000009 |
| unemp_pop   | 0.011926 | 0.026568  | 7.178 | 0.000 | 0.0261055 | 0.0097457 |
| pop_under_15| 0.0805169 | 0.065646  | 1.22  | 0.220 | -0.0681808 | 0.2091973 |
| pop_over_65 | 0.8679435 | 0.734457  | 11.82 | 0.000 | 0.7239926 | 0.1013949 |
| vturn       | 0.009854 | 0.0117704 | 0.84  | 0.402 | -0.0132555 | 0.0329236 |
| post_crisis | 0.070799 | 0.365747  | 1.93  | 0.053 | 0.3562655 | 0.787312 |
| emu_2       | -1.904642 | 0.305697  | -6.27 | 0.000 | -2.4994226 | -1.308866 |
| emu_2       | 0.059991 | 0.237396  | 0.23  | 0.815 | -0.4797932 | 0.5967114 |
| eufiscal_2  | -1.121289 | 0.3197267 | -3.68 | 0.001 | -1.7039542 | -0.5382368 |
| mixed       | -0.807229 | 0.4698681 | -1.72 | 0.086 | -1.4676194 | 0.1099752 |
| pr          | -0.281246 | 0.6412066 | 0.43  | 0.667 | -1.2584458 | 0.7559269 |
| continental | 7.921351 | 1.3228041 | 5.99  | 0.000 | 5.2276433 | 10.51556 |
| nordic      | 7.37994 | 1.499377  | 5.06  | 0.000 | 4.5196112 | 10.24027 |
| eastern     | 4.119653 | 1.699419  | 2.42  | 0.015 | 0.7885159 | 7.450833 |
| southern    | 1.563713 | 1.607591  | 0.96  | 0.337 | 1.6069576 | 1.563713 |
| cd_strength_strong | 0.0853207 | 0.3326109 | 0.27 | 0.781 | -0.5277909 | 0.703421 |
| cd_strong_interact | -0.94762 | 0.50669 | -1.75 | 0.040 | -2.941106 | -0.954134 |
| continental_interact | -0.909967 | 0.50723 | 1.80 | 0.072 | -1.903155 | 0.083122 |
| eastern_interact | 0.175549 | 0.1429724 | 0.30 | 0.761 | -0.050537 | 1.391537 |
| southern_interact | 0.172912 | 0.1876995 | 0.92 | 0.357 | -0.395582 | 0.739602 |
| emu_interact | 0.887085 | 0.7475999 | 1.14 | 0.254 | -0.29701 | 1.104279 |
| emu_interact | 1.127258 | 0.4572762 | 2.50 | 0.012 | 0.2722843 | 2.012089 |
| mixed_interact | 0.3676865 | 0.4552005 | 0.81 | 0.419 | -0.1259614 | 0.55123 |
| pr_interact | 1.890759 | 0.4750415 | 3.99 | 0.000 | 0.9568943 | 2.821232 |
| cd_strong_interact | -0.940071 | 0.456039 | -2.01 | 0.044 | -1.880749 | -0.000414 |
| sigma_u     | 1.099967 | 2.714974 | 0.40 | 0.687 | -4.227284 | 4.415217 |
| sigma_e     | 2.405553 | 0.000000 | 2.405553 |
| rho         | 0.76921189 | (fraction of variance due to u_i) |
### Unemployment Spending as % GDP

```
xrreg gvt_ss_unemp gdp_per econ_open female_labor unemp_pop pop_under_15 pop_over_65 vtturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed pr continental nordic eastern southern cd_strength_strong nordic_interact continental_interact eastern_interact southern_interact eu_interact emu_interact mixed_interact pr_interact cd_strong_interact, re
```

<table>
<thead>
<tr>
<th>Random-effects GLS regression</th>
<th>Number of obs</th>
<th>= 672</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group variable: country_id</td>
<td>Number of groups</td>
<td>= 28</td>
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<tr>
<td>R-sq: within = 0.5702</td>
<td>Obs per group: min = 24</td>
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<tr>
<td></td>
<td>between = 0.3317</td>
<td>avg = 24.0</td>
</tr>
<tr>
<td>overall = 0.3973</td>
<td>max = 24</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wald chi2(28) = 828.23</td>
<td></td>
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<tr>
<td>corr(u_i, X) = 0 (assumed)</td>
<td>Prob &gt; chi2 = 0.0000</td>
<td></td>
</tr>
</tbody>
</table>

| gvt_ss_unemp   | Coef. | Std. Err. | z      | P>|z|       | [95% Conf. Interval] |
|----------------|-------|-----------|--------|---------|------------------------|
| gdp_per        | -.0000181 | .0000524 | -3.78  | 0.000    | -.0000227 to -.0000134 |
| econ_open      | -.0014294 | .0013628 | -1.06  | 0.287    | -.0039926 to .0011397  |
| female_labor   | .0040777  | .0075934 | 0.53   | 0.592    | -.0118264 to .0200019  |
| unemp_pop      | .1322292  | .0652717 | 2.02   | 0.043    | .0018461 to .2626024   |
| pop_under_15   | .0952655  | .0173784 | 5.55   | 0.000    | .0608465 to .1396856   |
| pop_over_65    | -.0248659 | .0196903 | -1.26  | 0.209    | -.0624591 to .0129273  |
| vtturn         | -.0065509 | .0031541 | -2.07  | 0.038    | -.0127129 to -.000349  |
| post_crisis    | .3189976  | .0977805 | 3.26   | 0.001    | .1273514 to .5106499   |
| eu_2           | -.1774126 | .0821693 | -2.18  | 0.028    | -.3366669 to -.0181584 |
| emu_2          | .1070449  | .0679266 | 1.58   | 0.115    | -.0260983 to .2401822  |
| eu2020_2       | .219454   | .0824294 | 2.66   | 0.008    | .0578953 to .3810126   |
| eufiscal_2     | -.2650216 | .0854721 | -3.08  | 0.002    | -.4305538 to -.0995094 |
| mixed          | -.1126859 | .1235469 | -0.90  | 0.369    | -.3583214 to .1330295  |
| pr             | -.1694626 | .1720582 | -0.95  | 0.343    | -.5013551 to .1644259  |
| continental    | 1.059584  | .2665425 | 2.96   | 0.003    | .5675799 to 1.5504294  |
| nordic         | 1.280298  | .4040487 | 3.17   | 0.001    | .4853771 to 2.072219   |
| eastern        | -.8548691 | .4719297 | -1.81  | 0.070    | -.1778282 to .0655436  |
| southern       | .1790074  | .4444995 | 0.40   | 0.687    | -.692124 to 1.050259   |
| cd_strength_strong | -.0012951 | .0990384 | 1.31   | 0.189    | -.2023061 to .1977024  |
| continental_strong | -.0568194 | .1355456 | 4.04   | 0.000    | -.3236462 to -.2925544 |
| eastern_strong | .2867623  | .1354797 | 2.12   | 0.034    | .0212277 to .5522977   |
| southern_strong | -.3461554 | .1720506 | 2.01   | 0.043    | -.692124 to 1.050259   |
| eu_strong      | -.7486703 | .1279751 | -5.86  | 0.000    | -.9970224 to -.4903226 |
| emu_strong     | .6404711  | .1164407 | 5.58   | 0.000    | .4114142 to .8798011   |
| mixed_strong   | -.0040588 | .1217623 | -0.30  | 0.763    | -.2426262 to .2345087  |
| pr_strong      | .3918757  | .1270152 | 3.09   | 0.002    | .1429056 to .6408033   |
| cd_strong_strong | -.4024191 | .1219322 | -3.33  | 0.001    | -.6694019 to -.1354283 |
| sigma_u        | .6724628  |           |       |         |                        |
| sigma_e        | .3583542  |           |       |         |                        |
| rho            | .7831508  |           |       | (fraction of variance due to u_i) |
. xtreg almp gdp_per econ_open unemp_pop pop_under_15 pop_over_65 vturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed pr continental nordic eastern southern cd_strength_strong nordic_interact continental_interact eastern_interact southern_interact eu_interact emu_interact mixed_interact pr_interact cd_strong_interact, re

Random-effects GLS regression
Number of obs       =        672
Group variable: country_id
Number of groups   =         28

R-sq: within = 0.1693 Obs per group: min = 24
         between = 0.3046 avg = 24.0
         overall = 0.2773 max = 24

Wald chi2(28) = 126.81
Prob > chi2    = 0.0000

---------------------------------------------------------------------
              Coef.  Std. Err.     z    P>|z|    [95% Conf. Interval]
---------------------------------------------------------------------
gdp_per         -0.39e-06    2.30e-06   -2.78   0.005   -.0000109   .1.88e-06
econ_open       0.0020619    0.007655    0.26    0.797   -.005616   .005822
female_labor    -0.000170    0.041028   -0.04   0.970   -.001065   .001325
unemp_pop       0.010537    0.003468    3.06   0.002   .003982    0.017092
pop_under_15    0.052044    0.010348    5.01   0.000   .031877    0.072211
pop_over_65     0.041112    0.011759    3.55   0.000   .028242    0.054982
vturn           0.001601    0.001549   -0.06   0.951   -.003246   .006448
post_crisis     0.010902    0.057975    0.19   0.847   -.1.01941    1.041217
eu_2            0.129241    0.047527    2.63   0.009   .037286    0.221196
emun_pop        0.058976    0.039793    1.47   0.141   -.019422    0.137384
emu2020_2       0.036642    0.048554   -0.70   0.481   -.0.055221   .138507
eufiscal_2      0.009624    0.050146   -0.19   0.849   -.0.191558   .001958
mixed           -0.211287    0.073626   -2.87   0.004   -.3.55923   -.066988
pr              -0.229107    0.101160   -2.28   0.023   -.4.239742   .0.068391
continental     0.399652    0.210782    1.90   0.058   -.0.034752    0.733789
nordic          0.796552    0.232260    3.44   0.001   .340303    1.258299
eastern        -0.158739    0.270748   -0.58   0.566   -.6.589304   .372282
southern       -0.182954    0.253463   -0.71   0.476   -.4.319154   .605749
continental_mix 0.061398    0.021933    2.79   0.005   -.0.00627    1.029527
nordic_mix      -0.291823    0.098248   -2.96   0.003   -.0.485312   -.1.09844
continental_mix -0.041067    0.079794   -0.51   0.607   -.0.115990   .0.174613
eastern_mix     -0.110619    0.101576   -1.09   0.277   -.0.306592   .0.08523
southern_mix    -0.005039    0.09255   -0.05   0.959   -.0.189426   .1.883008
continental_mix -0.000702    0.075607   -0.09   0.929   -.0.176722   .1.075322
nordic_mix      -0.274268    0.068158   -4.06   0.000   -.0.410908   -.137528
mixed_mix       -0.007250    0.071841   -1.00   0.318   -.0.217779   .0.002288
pr_mix          -0.178274    0.074072   -2.38   0.017   -.0.326574   .0.070208
continental_mix 0.021670    0.071182   -0.30   0.765   -.1.10811    1.151454
nordic_mix      -0.357546    0.428053   -0.84   0.398   -.1.115706   .3.897007
continental_mix -0.773036    (fraction of variance due to u_i)
---------------------------------------------------------------------
sigma_u          0.386432
sigma_e          0.208581
rho               0.773036

Health Spending as % GDP

```
xtdreg health gdp_per econ_open female_labor unemp_pop pop_under_15 pop_over_65 vturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed pr continental nordic eastern southern cd_strength_strong nordic_interact continental_interact eastern_interact southern_interact eu_interact emu_interact mixed_interact pr_interact cd_strong_interact, re
```

Random-effects GLS regression Number of obs = 672
Group variable: country_id Number of groups = 28

R-sq: within = 0.5886 Obs per group: min = 24
between = 0.7864 avg = 24.0
overall = 0.7134 max = 24

Wald chi2(28) = 1297.21
Prob > chi2 = 0.0000

| health | Coef.  | Std. Err. | z   | P>|z|   | [95% Conf. Interval] |
|--------|--------|-----------|-----|-------|----------------------|
| gdp_per| 0.0000 | 0.0001    | 6.49| 0.000 | 0.0000   | 0.0000   |
| econ_open| -0.0088| 0.0010   | -8.73| 0.000 | -0.0103  | -0.0073  |
| female_labor| 0.0616| 0.0021   | 7.81| 0.000 | 0.0574   | 0.0658  |
| unemp_pop| 0.0414| 0.0022   | 4.90| 0.000 | 0.0371   | 0.0457  |
| pop_under_15| 0.1066| 0.0213   | 5.01| 0.000 | 0.0640   | 0.1488  |
| pop_over_65| 0.0611| 0.0218   | 2.82| 0.005 | 0.0188   | 0.1034  |
| vturn| -0.0095| 0.0010   | -1.24| 0.214 | -0.0115  | -0.0075  |
| post_crisis| 0.7131| 0.1561   | 4.67| 0.000 | 0.4081   | 1.0182  |
| eu_2| 0.0642| 0.0020   | 3.20| 0.001 | -0.1214  | 0.3518  |
| emu_2| 0.1690| 0.0014   | 1.19| 0.237 | -0.1550  | 0.5030  |
| eu2020_2| -0.1540| 0.1362   | -1.13| 0.257 | -0.4182  | 0.1102  |
| eufiscal_2| -0.1282| 0.1409   | -2.88| 0.004 | -0.4085  | 0.1520  |
| mixed| -0.1520| 0.1311   | -1.17| 0.243 | -0.4081  | 0.1041  |
| pr| -0.1699| 0.1557   | -1.10| 0.269 | -0.4795  | 0.1406  |
| continental| 1.6926| 0.1466   | 11.68| 0.000 | 1.3022   | 2.0830  |
| nordic| 0.9240| 0.1521   | 6.10| 0.000 | 0.6239   | 1.2242  |
| eastern| 0.1946| 0.1801   | 1.08| 0.280 | -0.1842  | 0.5735  |
| southern| 0.0169| 0.0067   | 2.53| 0.011 | -0.0008  | 0.0346  |
| cd_strength_strong| -0.0474| 0.0112   | -4.21| 0.000 | -0.0696  | -0.0252 |
| nordic_interact| -0.3071| 0.2156   | -1.44| 0.149 | -0.7326  | 0.1284  |
| continental_interact| -0.3650| 0.2147   | -1.72| 0.085 | -0.7915  | 0.0615  |
| eastern_interact| -0.5335| 0.2670   | -2.00| 0.045 | -1.0511  | 0.0041  |
| southern_interact| -0.1466| 0.2527   | -0.58| 0.561 | -0.6485  | 0.3554  |
| eu_interact| 0.6146| 0.2061   | 2.97| 0.003 | 0.2103   | 1.0189  |
| emu_interact| -0.5386| 0.1763   | -3.03| 0.002 | -0.8832  | -0.1940 |
| mixed_interact| -0.1203| 0.0927   | -1.30| 0.199 | -0.3040  | 0.0634  |
| pr_interact| 0.1508| 0.2081   | 0.72| 0.469 | -0.2642  | 0.5660  |
| cd_strength_strong_interact| -0.1749| 0.0971   | -1.80| 0.071 | -0.3702  | 0.0204  |
| pr_interact| -0.0198| 0.0091   | -2.18| 0.029 | -0.0380  | -0.0016 |
| sigma_u| 0.1163| 0.0202   | 5.75| 0.000 | 0.0766   | 0.1561  |
| sigma_e| 0.0802| 0.0130   | 6.08| 0.000 | 0.0546   | 0.1058  |
## Family Spending as % GDP

:xtreg family gdp_per econ_open female_labor unemp_pop pop_under_15 pop_over_65 vturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed pr continental nordic eastern southern cd_strength_strong nordic_interact continental_interact eastern_interact southern_interact eu_interact emu_interact mixed_interact pr_interact cd_strong_interact, re

| Note: eu2020_2 omitted because of collinearity |
| Note: eufiscal_2 omitted because of collinearity |

### Random-effects GLS regression

| Number of obs | = 545 |
| Number of groups | = 28 |

**R-sq:**
- within = 0.4014
- between = 0.4159
- overall = 0.4241

| Obs per group: min | = 11 |
| avg | = 19.8 |
| max | = 20 |

| corr(u_i, X) | = 0 (assumed) |
| Wald chi2(25) | = 241.91 |
| Prob > chi2 | = 0.0000 |

### Variable Coefficients

| family | Coeff. | Std. Err. | s | P>|t| | [%95% Conf. Interval] |
|---|---|---|---|---|---|
| gdp_per | 3.30e-06 | 3.69e-06 | 0.59 | 0.371 | -3.93e-06 | .0000105 |
| econ_open | 0.002623 | 0.001208 | 2.11 | 0.044 | 0.0000464 | .0053945 |
| female_labor | 0.0465159 | 0.008702 | 5.22 | 0.000 | 0.0286987 | .0643321 |
| unemp_pop | 0.005964 | 0.0036203 | 0.25 | 0.969 | -0.070696 | .178625 |
| pop_under_15 | 0.026986 | 0.0161278 | 1.68 | 0.101 | -0.006014 | .0591286 |
| pop_over_65 | 0.012086 | 0.0129713 | 1.78 | 0.075 | 0.0000534 | .0590227 |
| vturn | -0.000679 | 0.0013499 | -0.22 | 0.826 | -0.002122 | .0000768 |
| post_crisis | 0.0000003 | 0.0010602 | 0.22 | 0.826 | -0.0000777 | .0000229 |
| eu_2 | -0.4148932 | 0.069711 | -6.16 | 0.000 | -0.5776501 | -0.252825 |
| emu_2 | -0.029481 | 0.0098767 | -0.36 | 0.714 | -0.1855224 | .0266262 |
| eufiscal_2 | 0 (omitted) |
| mixed | 0.095267 | 0.1046674 | 0.89 | 0.373 | -0.1118576 | .298431 |
| pr | 0.13002 | 0.149626 | 0.89 | 0.373 | -0.1118576 | .298431 |
| continental | 1.124998 | 0.2958286 | 3.86 | 0.000 | 0.5637045 | 1.682691 |
| nordic | 1.362404 | 0.3259264 | 4.19 | 0.000 | 0.7266443 | 2.000166 |
| eastern | 0.762927 | 0.3791413 | 2.02 | 0.045 | 0.1250994 | 1.409306 |
| southern | 0.147163 | 0.3853218 | 0.40 | 0.688 | -0.5555639 | 0.8545964 |
| cd_strength_strong | 0.045923 | 0.0786789 | 0.59 | 0.528 | -0.106155 | 0.202800 |
| nordic_interact | -0.449897 | 0.1729424 | -2.63 | 0.009 | -0.794091 | -0.105094 |
| continental_interact | -0.412864 | 0.1752247 | -2.37 | 0.018 | -0.746259 | -0.084621 |
| eastern_interact | -0.0574223 | 0.2181175 | -0.26 | 0.792 | -0.4880467 | 0.3700401 |
| southern_interact | -0.2507056 | 0.20419 | -2.63 | 0.009 | -0.6557267 | -0.055966 |
| eu_interact | 0.1750614 | 0.150134 | 1.19 | 0.236 | -0.116194 | 0.4750423 |
| emu_interact | 0.011695 | 0.1473043 | 0.07 | 0.970 | -0.2770736 | 0.300350 |
| mixed_interact | 0.0012297 | 0.1642948 | 0.07 | 0.970 | -0.2046007 | 0.210885 |
| pr_interact | 0.3585942 | 0.1637276 | 2.19 | 0.029 | 0.067939 | 0.6719444 |
| cd_strength_interact | -0.5242442 | 0.1716275 | -3.05 | 0.002 | -0.860628 | -0.187804 |
| cons | -2.217995 | 0.70567 | -3.24 | 0.001 | -4.571086 | -0.849104 |

sigmu | 0.50916274 |
 sigmem | 0.27617683 |
 rho | 0.7722999 (fraction of variance due to u_i) |
## Old Age Spending as % GDP

```
xr Old_age_2 gdp_per econ_open female_labor unemp_pop pop_under_15 pop_over_65 vturn post_crisis eu_2 emu_2 eu2020_2 eufiscal_2 mixed_pr continental_nordic eastern_southern cd_strength_strong nordic_interact continental_interact eastern_interact southern_interact eu_interact emu_interact mixed_interact pr_interact cd_strong_interact, re
```

<table>
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<th>R-sq: within = 0.267</th>
<th>Obs per group: min = 13</th>
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<tbody>
<tr>
<td>between = 0.7960</td>
<td>avg = 21.2</td>
</tr>
<tr>
<td>overall = 0.7804</td>
<td>max = 24</td>
</tr>
</tbody>
</table>

Wald chi²(28) = 1511.25  
Prob > chi² = 0.0000

---

### Coefficients

| Variable          | Coef. | Std. Err. | z     | P>|z| | 95% Conf. Interval |
|-------------------|-------|-----------|-------|------|-------------------|
| gdp_per | .000167 | .615e-06 | -2.70 | 0.007 | 4.55e-06 - 1.00e-05 |
| econ_open | -.0249394 | .0022795 | -10.90 | 0.000 | -.029071 - -.020718 |
| female_labor | -.3666586 | .010407 | -4.76 | 0.000 | -.486815 - -.246503 |
| unemp_pop | .1221464 | .0104721 | 11.66 | 0.000 | .1016215 - .1426714 |
| pop_under_15 | -.0582833 | .0273588 | -2.11 | 0.036 | -.1078666 - .0012806 |
| pop_over_65 | .1329723 | .032204 | 16.04 | 0.000 | .4678616 - .506083 |
| vturn | -.0049559 | .0049237 | -0.91 | 0.364 | -.0155901 -.0056703 |
| post_crisis | -.0200687 | .1765674 | -0.12 | 0.908 | -.3770904 -.3258729 |
| eu_2 | .1285854 | .1202927 | 1.05 | 0.294 | -.1094111 - .3621728 |
| emu_2 | .2248959 | .1012621 | 2.18 | 0.029 | .0226608 - .0432282 |
| eu2020_2 | .1257582 | .1150099 | 1.31 | 0.056 | -.0056615 - .045279 |
| eufiscal_2 | .0972991 | .273302 | 0.34 | 0.731 | -.4418629 .6294612 |
| mixed | -.1877666 | .1844261 | -4.55 | 0.000 | -1.227074 - -.848186 |
| pr | -.1028865 | .2677783 | -1.88 | 0.060 | -2.02772 - .0209432 |
| continental | 2.797424 | 1.905281 | 3.01 | 0.003 | .9766228 - 4.612226 |
| nordic | 2.252625 | 1.0239797 | 2.21 | 0.027 | .2394444 - 4.205046 |
| eastern | 3.062927 | 1.12662 | 2.52 | 0.012 | .6797662 - 5.448828 |
| southern | .5001559 | 1.117321 | 0.45 | 0.653 | -.678756 - 2.679148 |
| cd_strength_strong | -.1157054 | .132204 | -1.42 | 0.156 | -.266091 - .034502 |
| nordic_interact | -.1094522 | .226 | -4.94 | 0.000 | -1.357474 - -.8516589 |
| continental_interact | -.249103 | .2251988 | -1.11 | 0.269 | -.6797662 - 2.191982 |
| eastern_interact | .2014041 | .221461 | 0.90 | 0.368 | -.4628759 - .445287 |
| southern_interact | -.1483783 | .2632066 | -1.73 | 0.084 | -.3171242 - .0215984 |
| eu_interact | .7755072 | .2076775 | 3.73 | 0.000 | .3684668 - 1.182584 |
| emu_interact | .181054 | .180861 | 0.66 | 0.508 | -.901674 - 1.263743 |
| mixed_interact | -.4616627 | .2263497 | -2.04 | 0.041 | -.9052707 - .019948 |
| pr_interact | .7742319 | .2248549 | 2.11 | 0.035 | .2918259 - .1194414 |
| cd_strength_strong | -.7794221 | .2010182 | -3.85 | 0.000 | -1.167559 - -.409363 |
| _cons | 3.446176 | 1.124486 | 2.60 | 0.009 | .8502319 - 6.04212 |

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sigma_u | 1.1052059 |
sigma_e | .34023407 |
rho | .26752269 (fraction of variance due to u_i)