INTERNATIONAL LABOUR MARKET
AND SOCIAL POLICY ANALYSIS

Essays on segmentation, cross-national variation
and European Union regulation

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Preface

This book contains three essays written during the late 1980s and early 1990s on labour market segmentation theory, international welfare state comparisons, and European Union regulation of social security that have been circulating within the international welfare state and labour market policy research community but so far have not been available for a wider audience. The first and third essays have undergone a thorough linguistic revision. The first essay has also been given a new introduction aimed at more clearly presenting the wider context of the segmentation debate. The third essay is a background paper for an article that was published in Castro et al (1992) but this volume has been out of print and unavailable since the mid 1990s.

The essays are linked by a general concern about international developments, both on the intellectual and on the economic and political level. Debates about the welfare state have always been strongly international in their origin and orientation. Already in the nineteenth century policy makers were heavily involved in the international exchange of policy ideas and academic scholars were concerned with coming to grips with the analytics and empirics of the social issues and policies in the different industrial countries. Probably as a result of the expansion of mass universities and the greater use of university graduates in routine public administration, during the 1970s and 1980s much of the traditional international orientation of research and policy making was lost when scholars became more concerned and preoccupied with the detailed exploration of the conditions in their home countries and the national context. The essays in this book break with this national-ethnocentric turn and, by placing the international context at the centre stage of the examinations, rekindle the traditional international orientation of research and scholarship.
The first essay debates the labour market segmentation theories that have been developed from the 1970s onwards by scholars at the Massachusetts Institute of Technology, USA; the University of Cambridge, UK; and the University of Munich, Germany. The common feature of this school of thought is the assertion that the labour market is divided into distinct segments and within each of these segments market and social processes function and interact in distinct ways. On the basis of this viewpoint, three very different theories of the functioning of the labour market have developed. The concern of this essay is to critically clarify and compare the underlying analytical principles of these theories and the direction of scholarly development they are stipulating. It concludes that the international segmentation community would benefit from putting aside its many battles with the mainstream world and by becoming more focused on clarifying a more limited number of issues, such as the determinants of the living and working conditions of disadvantaged groups in the labour market.

The second essay on cross-country comparisons of welfare state policies examines the strengths and limitations of cross-country research. The general point of departure of this paper is that cross-country research should not be regarded as a special branch of enquiry but ought to be an integral component of mainstream economic research disciplines. Welfare state research is traditionally conducted on the basis of a broad public economics framework and this paper examines in detail the extent to which directing the focus away from single country studies and moving towards systematic international comparisons can help develop this branch of economics. Theories from the political sciences are also briefly considered as are the problems of obtaining adequate information and data to permit the carrying out of international comparisons. It is argued that the neglect of cross-country comparisons in public economics is mainly the result of limited effort and not lack of relevance, in that a number of theoretical and empirical issues could be clarified by using cross-country material. Both global and spatial comparative perspectives are useful, although current large scale multi-country studies tend to lack accuracy with regard to the essential features of the institutional arrangements in different countries.
The third essay on the regulation of social protection in the European Community examines firstly the extent to which European economic integration might lead to a harmonisation and convergence of existing national social security systems and secondly the European Commission’s proposals for developing a social dimension within the European Community in addition to its current economic political dimension. Existing variations in social security systems within the European Community is illustrated by comparing the basic features of the unemployment compensation schemes operating in Great Britain, Germany, and Denmark. A comparison between the US experience of a federal unemployment insurance system and current trends in the European Community is also performed. This essay concludes that a spontaneous market driven harmonisation of national social protection systems is likely to lead to adverse outcomes and that, in this regard, a more positive approach and further political initiatives warrants further consideration.
1. Labour markets and the three worlds of segmentation theory

1.1 Introduction

The market for labour has been a central concern of social science and economics for the whole of this century and it has also been a subject area where views have been strongly shaped by international debate. According to Paul McNulty’s history of labour economics in the United States, the constitution of the American Economic Association from 1886 stated that “the conflict of labor and capital has brought into prominence a vast number of social problems, whose solution requires the united efforts, each in its own sphere, of the church, of the state, and of science” (McNulty 1980 p 143). In the same context, McNulty (op cit. p 139) emphasises the influence German historical and comparative approaches had on contemporary American research whilst in the years that followed the works by Sidney and Beatrice Webb, who themselves were inspired by German approaches, also made a substantial international impact (see also op cit. pp 131 for details concerning the German influence). The inter-war years were the age of British supremacy, first with the spread of Alfred Marshall’s doctrines and later based on the theoretical works of John Hicks, Arthur Pigou, Joan Robinson and others. The focus of attention underwent a transformation from a concern with “labour problems” to a concern with “labour economics” and the way in which the many peculiarities of labour demand and supply influence labour market processes (Marshall 1920 Book VI chapters IV and V).

Current international debate about the functioning of labour markets has without any dispute its origin in American controversies. Originating in the Chicago economics department during the late 1950s and early 1960s we have witnessed a renewed transformation of labour economics aiming at integrating labour
economics more closely with the parent discipline of neoclassical microeconomic theory. This includes placing greater emphasis on analytical and quantitative work, initiated by Gregg Lewis and his students, and the establishment of the human capital school of thought by Jacob Mincer, Theodore Schultz and Gary Becker. Mainly with a base in Harvard and MIT (Cambridge, Massachusetts) and under the heading of “labour market segmentation theory” Michael Piore and other scholars have since the late 1960s aimed at developing an alternative theory of the functioning of the labour market to the prevailing “orthodox” theory. This includes Piore’s own “dual labour market theory” but also so-called “radical” or Marxist approaches and theories. Elsewhere in America efforts were initiated at integrating micro- and macroeconomic theory and to provide what has been termed a microeconomic foundation of employment and inflation theory (Phelps (eds) 1970). Twenty years later, the debates and controversies surrounding these efforts continue to shape labour market research, not only in America but also in Europe.

This essay has the limited purpose of reviewing and debating labour market segmentation theory, which, as we have seen, is only one direction of current labour market research derived, to a large extent, out of a criticism of recent trends in the mainstream. The essay is further limited by focusing on work done in and around the “International Working Party on Labour Market Segmentation” which was founded in 1979 by scholars from a number of European countries and the USA. “Radical” or Marxist theories are not considered (Gordon 1972 chapter 5, Gordon et al 1982) and neoclassical approaches are only considered in the context of my debate of the internal labour market hypothesis. Further segmentation analyses within the neoclassical line of thought are considered and developed in Wachter (1974), Taubman and Wachter (1986), Minford (1983), and Bulow and Summers (1986) amongst other places.

The theories I consider are firstly Peter Doeringer and Michael Piore’s internal labour market hypothesis as presented in the seminal “Internal Labor Markets and Manpower Analysis” and the hypothesis’ further development in the Munich segmentation model, put forward by Burkhard Lutz and Werner Sengenberger at the “Institut für Sozialwissenschaftliche Forschung” in Munich with Sengenberger as
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the main thinker and architect. The internal labour market hypothesis initiated a wide range of research and is generally conceived as the core hypothesis of the segmentation literature, both by those working within the framework of economic orthodoxy and by alternativists. Sengenberger earned his PhD in the Industrial Relations department of the University of Chicago before joining the Munich institute in 1972. His thinking on segmentation has been highly influential both in Germany and elsewhere. Post-war developments of modern labour economics appear to have passed Germany by. Even detailed literature bibliographies do not mention any German work in the field from before 1970 (Bolle 1976, Langenbrinck 1977). During the late 1970s Sengenberger’s theory became a theoretical base and point of departure for much of the research conducted at the Federal Employment Agency’s “Institute for Employment Research” (“Institut für Arbeitsmarkt- und Berufsforschung”, IAB) which had been established in the late 1960s. In other words and a bit acuminated, what in America was viewed as an alternative theory became German orthodoxy. His theory was a central point of debate in several contact seminars between IAB researchers and university scholars and even though his influence has waned in recent years and his more recent empirical work has gained less attention (Sengenberger 1987), Sengenberger’s version of segmentation theory continues to exert an important influence on German and international labour market research.

Secondly, I consider Michael Piore’s dual labour market theory and its further development in recent joint work with Suzanne Berger and Charles Sabel. In parts of the literature, the dualism that is argued in the internal-external labour market hypothesis and in Piore’s dual labour market model is assumed to be one and the same. However, whilst the descriptions of the labour market are similar, I argue that we are dealing with two very different theoretical constructions. While the analytical framework of the internal-external labour market hypothesis is clearly neoclassical, Piore departs radically from this line of thought in his dual theory and in his related work on industrial society and labour market stratification. It is always difficult to assess the intellectual bases of joint work but it appears that the internal
labour market hypothesis presented in Doeringer and Piore (1971) is probably more the result of Peter Doeringer’s than Piore’s pen.

Finally, I consider the segmentation theory developed by Frank Wilkinson and his colleagues in the “Labour Studies Group” at the Department of Applied Economics in Cambridge, UK. The group was the initiator of the establishment of the “International Working Party on Labour Market Segmentation” and the party’s first conference was held at the University of Cambridge. The Cambridge group see their work in opposition to neoclassical theory both with respect to the way in which labour markets operate, the relationships between economic, social, and institutional forces, the conceptualisation of these forces, and with respect to the relationships between product markets, industrial structure, and labour markets. On the other hand, the work of the group can also not be said to relate particularly closely to Michael Piore’s concerns and dual labour market model.

I began this work with the expectation of discovering and gaining an understanding of a common framework of analysis and a common purpose in the work of segmentation theorists. Yet, as already indicated, this has turned out to be mistaken. In a paraphrase of the title of a recent book edited by Mangum and Philips (1988) I have come to the conclusion that it would be more appropriate to talk about the three worlds of segmentation theory rather than a group of people engaged in joint efforts to develop an understanding of the operations of labour markets. Overall the literature remains ambiguous in purpose both on the level of theory and methodology.

On the one hand, segmentation theorists appear to accept the view that a theory of the labour market needs to be based on a wider analytical theory of the economy. The literature makes extensive references to the need of establishing a theoretical paradigm and basis and to the existence of an ongoing competition between different labour market theories (Gordon 1972, Pfriem 1979, Piore 1983, Tarling 1987). Lutz and Sengenberger’s (1978) mission statement emphasises that in the absence of theoretical foundations the explanatory power of empirical work remains limited. On the other hand, the actual work is strongly policy orientated and related to particular debates. Gordon (1972 p 43) highlights that many hypotheses in the
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literature are “time specific” and Lutz and Sengenberger (1980 p 292) note that the more specific segmentation concepts have been developed in a “very specific national and historical context”. However, the general tone of the literature and the basis of my debate in the succeeding sections is that the theorists are engaged in developing a general theory and not merely concerned with illuminating one or two peculiarities of the labour market which orthodoxy might have overlooked or with the expression of various current affairs opinions. I have taken seriously the different scholars’ and research groups’ claims of being theory developers, and my concern is to critically clarify what these theories are and the direction of analytical development they are stipulating.

A similar ambiguity concerns empirical methodology. Nowhere in the literature reviewed in this essay do we find an explicit exposition and positive explanation of the required empirical methodology. In a heated and emotional exchange with Michael Wachter, who we might term a mainstream neoclassical segmentation analyst, Michael Piore emphasises that the concepts of internal labour market and dual labour market “derive from open-ended interviews with the actors and from the experience of the researchers themselves in various projects and programs. Many of these features of the internal labor market, and some of the dual labor market, are also written in legislation, court opinions, collective bargaining agreements, arbitration awards, and the like. All of this is evidence, if not the kind normally admitted in the court of economics. For those of us who have collected it, and remain immersed in it, it is overwhelming evidence. And I, for one, am not about to dismiss any of the constructs simply because econometric evidence fails to support it” (Piore 1974 pp 684-685). Gordon (1972 pp 43, 53) also explains that the empirical material that spurred the emergence of both “radical” and dualist theories was gathered in a number of case-studies of urban poverty and underemployment. All of the theories debated in this essay follow in this tradition and are largely build on non-quantitative work but the extent to which this means that quantitative work has no value and should be abandoned is not clear in the absence of more general reflections and statements by the theorists. In the conclusion I return briefly to the
issue of the empirical basis of the segmentation theories that are debated in this essay.

As has already been noted, on the substantive level the theories that will be debated in the succeeding sections have little in common. However, a few general features on the level of description of the labour market can be discerned. They all apply the kind of taxonomy which was first advanced by Clark Kerr in his “Balkanization of Labor Markets” from 1954 (reprinted in Kerr 1977). In this essay Kerr distinguished between internal and external labour markets, whereby the internal labour market could be divided further into the craft and the industrial type market. “The internal market may be the plant or the craft group, and preferment within it may be based on prejudice or merit or quality of opportunity or seniority or some combination of these. The external market consists of clusters of workers actively or passively available for new jobs lying within some meaningful geographical and occupational boundaries, and of the port or ports of entry which are open or are potentially open to them” (Kerr 1977 p 30). A further substantive point is that all theories operate with a notion of dualist industrial structures of the kind that was debated by Robert Averitt (1968) with regard to the American structure. A distinction is generally made between a core, primary and a less developed secondary industrial sector. In the most simple model, industrial and labour market structures closely match but all theorists postulate more complex relationships between the two structures.

It would however be wrong to say that the segmentation theories debated in what follows base their approaches on these predecessors. Only early work by Doeringer (1967) builds on and debates explicitly the Kerr model; other scholars make only rudimentary references to this tradition or do not refer to it at all. Instead, as will appear from the succeeding debate, each research grouping tend to introduce their own classifications and taxonomies.
1.2 Internal labour markets and the Munich segmentation model

Several contributors to the segmentation debate have pointed out the eclectic (Gordon, Edwards, and Reich 1982) or ad hoc (Rubery 1978, Loveridge and Mok 1979, 1980) character of the internal labour market hypothesis. Several interpretations of what the hypothesis means and implies is possible. Even though many writers applying the internal labour market concept dish out frequent swipes at neoclassical theory, the interpretation presented below views the hypothesis as an extension of the neoclassical paradigm. On the basic descriptive level, the internal labour market hypothesis relates to “internal job structures within firms” (Garnsey et al 1985 pp 54) and to “employment practices within firms” (Osterman 1984 p 2). But in opposition to approaches in industrial and organisational sociology and management science, the distinguishing feature of the internal labour market theory is that it investigates these structures and practices on the basis of a broad neoclassical framework to the analysis of non-market allocation, market imperfections and disequilibrium in the labour market. Doeringer and Piore (1971 p 5) emphasise that neoclassical theory has to be regarded as “the coherent labour market theory, against which an internal labour market theory must be tested” and in the German debate Brinkmann (1979 p 206) argues that “a labour market which does not contain segmentation would depict the marginal case of perfect flexibility, in which any barriers to mobility and substitution as well as any kind of structural unemployment would be absent”.

In the next section I explore the view of the functioning of the labour market that follows from Peter Doeringer and Michael Piore’s hypothesis as well as from similar hypotheses advanced by Arthur Okun and Walter Oi. I then look at the factors that are advanced in the literature as explanations for the existence of internal labour markets. These include the cost considerations of firms, human capital investments, and trade unions. The segmentation model that has been developed by Burkhard Lutz and Werner Sengenberger at the “Institut für Sozialwissenschaftliche Forschung” in Munich is also debated in some detail. In the final section policy implications and long-term adjustment processes in the labour market are considered.
1.2.1 Internal markets and the working of the labour market

In Doeringer and Piore’s (1971) theory the market as it is defined in traditional neoclassical theory makes up the economic context within which the internal labour market operates. Firms are profit- and workers are utility-maximizers and engage in mutual beneficial exchange and transactions. The external labour market adheres to the features of the competitive paradigm in that firms and workers engage in a process of perfect competition in a “spot or auction market”. By contrast, in a development of Oi’s (1962) notion of labour as a quasi-fixed factor of production, Doeringer and Piore state that the decisive phenomena defining internal labour markets is the existence of long-term employment relationships or stability of employment within firms: “Stability of employment is the most salient feature of the internal labour market. With stability comes rigidity and irreversibility in the administrative rules governing such markets” (op cit. p 40). Stability of employment and the related administrative rules are a response to the technical and social nature of the workplace whereby three factors can be distinguished: (a) skill specificity, (b) on-the-job-training, (c) workplace customs.

(a) Skill specificity is determined by the technological structure of the plant, the specificity of a job, and by the social skills that are needed in order to function within the working community. (b) On-the-job-training is important for the evolution of internal labour markets since many types of skills can only be obtained on the job. This means that the organisation of the training process is important as new workers learn from other workers and from gradually learning new and more complicated tasks whilst being employed by a firm. (c) Custom at the workplace is defined as an unwritten set of rules based largely upon past practice or precedent. Long-term stable employment patterns lead to the formation of social groups and communities within firms which in turn tend to generate rules governing the actions of their members and the relationship between members and outsiders. Doeringer and Piore emphasise that skill specificity, on-the-job-training, and workplace customs place a tremendous amount of power in the hands of the experienced and specialised work force.
In this conceptualisation of internal and external labour markets the indirect influence of market forces on the allocation and pricing of labour within the firm is emphasised. Doeringer and Piore find that the utility of the internal market as an analytical construct does not only depend upon the existence of administrative rules within the firm. If the rules respond freely to variations in economic conditions, their independent economic role will be minimal. Therefore the importance of the internal labour market as an analytical construct depends upon “the rigidity of the rules which define the boundaries of internal markets and which govern pricing and allocation within them” and “if, however, the rules are rigid, they will interrupt or transform economic influences causing the internal labor market to respond to dynamic events in a manner not readily predicted from conventional economic theory” (op cit. p 5). It is furthermore emphasised that many of the rigidities which impede market forces in the short run are eventually overcome in the long run, and there is probably a tendency for the economy to adjust, in time, in a direction consistent with the predictions of conventional competitive theory.

In recent work by Okun (1981) and Oi (1983) these ideas are developed further. Okun argues that the existence of long-term employment relationships constitutes a complex maximisation problem for firms. Firms need not only to minimise wage and labour costs but need also to develop strategies that enhance productivity. Firms can choose between a personnel strategy that relates to the career aspirations of workers or they can choose a strategy utilising casual labour. “When the majority of firms pursue career personnel strategies, they create a “hole” in the labour market to be filled by firms that choose the opposite, casual strategy” (Okun 1981 p 81). The casual strategy is most appealing to firms that can routinise and simplify worktasks and minimise productivity differences among individuals. By contrast, the career strategy appeals to high productivity firms utilising differentiated methods of production. Okun argues that in career markets certain set-up costs are incurred on a once-and-for-all basis when employment is initiated. These costs do not vary with the rate of utilisation of labour and are shared between the employee and the employer. Each side accepts certain sacrifices in the short run in order to maintain the relationship in the long run, and through the contributions to the set up costs, the
employer will have an investment in his workers, and workers will have an investment in their firm (op cit. pp 75). Norms and implicit contracts develop to secure that the agreements between the two parties are kept throughout the employment relationship.

Oi (1983) has developed similar lines of thought in a slightly different direction which relate variations in labour market structure to variations in entrepreneurial ability, the birth and death of firms, and the variation in the size of firms. His point of departure is that “a comparatively small number of firms grow to extraordinary large sizes because they are controlled by exceptionally talented and able entrepreneurs” (op cit. p 63). These firms produce standardised products for large markets and employ complex and rigid production processes. Each giant firm is characterised by a unique, idiosyncratic work organisation which also requires large investments in specialised workers who are rewarded with compensation packages that guarantee stable wages and tenured employment. Wage earners with an aversion against the large organisations and rigidities of giant firms must accept unstable employment and the risk of unemployment resulting from the shorter life expectancy of small firms.

1.2.2 Internal labour markets and the cost considerations of firms

Although Doeringer and Piore, Okun, and Oi emphasise different factors leading to the development of long-term employment relationships and internal labour markets, the hypotheses also exhibit a number of common features. Firstly, it is a characteristic of all three hypotheses that the distinguishing feature of the labour market structure is shaped by the impact of the strategies of the firms within the technologically developed and most efficient part of the economy. Secondly, it is a common characteristic that internal labour markets develop on the basis of considerations concerning the most efficient organisation of the production process. Thirdly, all three hypotheses emphasise that there are both economic advantages and costs linked to the development and operation of internal labour markets. Internal labour markets only replace competitive markets when costs to the firm are reduced as a result.
In what follows I will briefly consider the last point in further details on the basis of Doeringer and Piore’s analysis. In their view three factors influence the cost considerations of firms (op cit. pp 27): (a) the value of internal labour markets to the workers and the costs of attracting workers; (b) the size of replacement and termination costs; (c) the technical efficiency in recruitment, screening, and training.

(a) The value of internal labour markets to workers

When attracting workers and attaching them to the firm employers need to take the workers’ valuation of the job into account. Both as regards of the workers intending to enter into a long-term employment relationship and as regards the workers within such relationships the crucial point is the relationship between wages and the workers expectations. A violation of these expectations will not only lead to increases in quit-rates, but also to the development of a negative reputation of the firm which in turn would endanger the future attraction of workers. Doeringer and Piore find that the benefits which workers receive from internal labour markets appear to derive primarily from enhanced job security and the chances of career advancements available within them. Wage sacrifices which are necessary to attain access to an internal labour market thus represent a trade-off between present and future earnings.

(b) Replacement and termination costs

The existence of internal labour markets leads to costs of the replacement of workers and to costs of termination of employment relationships. Replacement costs have three major components: (i) recruitment, which consists of the costs of attracting candidates; (ii) screening, which consists of the costs of assessing the qualifications and attributes of candidates; (iii) training, which consists of the costs of raising the performance level of a newly hired or promoted worker to that of his predecessor. The costs of termination is indirectly influenced by the workers’ costs of job search, as workers with high search costs seek to limit the employers’ freedom to initiate terminations. By placing constraints upon the conditions under
which discharges or layoffs can occur, hiring decisions cannot be easily reversed, and a premium is placed upon a careful and expensive screening of applicants.

(c) Technical efficiencies in recruitment, screening and training

One of the problems for the firm by hiring workers in the external market and which contributes to the costs of replacement of workers derives from the existence of imperfect information about the attributes of the candidates in that market. Following these lines of thought Doeringer and Piore point out that the efficiency of internal recruitment and screening derives from the fact that existing employees constitute a readily accessible and transparent source of supply whose skills and behavioural characteristics are well known to management. Information about internal candidates is generated as a by-product of their work history in the enterprise, and management also has a record of the workers’ attendance, punctuality, and willingness to operate within the established work norms. Furthermore, internal screening and recruitment might also be necessary because of the nature of the training process. Many types of skills can only be learned on-the-job where workers learn from one another and then gradually learn new and more complicated tasks.

What is more, internal advancements for example in the form of seniority rules might be a part of the worker’s expectations and an implicit contract. A worker might accept employment with the expectation that seniority and other rules will operate in the future to improve his earnings. A violence of these expectations may lead to sanctions in the form of adverse working behaviour, and as already pointed out above, it might also affect future recruitment. Management might respond to these expectations and agree upon restrictions upon entry and the insulation of internal workers from external competition through certain employment and promotion guarantees.
1.2.3 Human capital and the Munich segmentation model

The Doeringer and Piore model focuses on the functioning of industrial type internal labour markets. In a German context Lutz and Sengenberger (Lutz and Sengenberger 1974, 1980, Sengenberger 1975, 1978a, 1978b) have developed a highly influential model which aims to integrate all types of labour markets in a unified analysis based on what they describe as a “modified human capital approach” (Sengenberger 1975, 1978a p 33). In pursuing this broader perspective, they relate more closely to the concerns of Clark Kerr from the early 1950s that aimed at understanding the structure of the labour market as a whole. Indeed, similar to Kerr, Lutz and Sengenberger view the labour market as divided into three segments consisting of the “unspecific sub-market”, the “craft sub-market”, and the “firm-specific sub-market”.

The modification of human capital theory consists of placing more emphasis on the demand side and on institutional rules governing remuneration, access to qualifications, and labour market regulation than is done in the orthodox theory. It is emphasised (Sengenberger 1975) that the model needs to be understood as an ideal-typical construct and that the three sub-markets or segments are analysed on the basis of two assumptions: firstly it is assumed that the markets are only determined by job-contents and qualifications and secondly it is assumed that they are distinctive from each other, by which is meant that most of the characteristics from one sub-market are not present in the other markets and there is no mobility between the markets. The markets are analysed along four dimensions: (i) the condition for the origin of the markets, (ii) the internal structure of the markets, (iii) the possible forms of institutionalisation, and (iv) the labour market political issues arising in the three markets. I now briefly summarise the main features of the three markets as these are presented by Lutz and Sengenberger.

The unspecific sub-market is characterised by a situation whereby qualifications are not specific for one area of employment. The conditions for its origin is that there exists a high degree of fluctuations in supply and demand which leads to low investment in both physical and human capital. A second condition is that there is a low degree of utilisation of economic resources, leading to a labour market that is
characterised by low adjustment costs - no additional qualifications are necessary in the event of job changes. The anticipated period of employment in one job is short and relatively small differences in wages lead to mobility. In this market no interests exist in the institutionalisation of allocation and gratification.

The craft sub-market is characterised by a situation whereby qualifications are specific for one trade or occupation. The demand for and supply of labour in relation to one firm is variable but in the trade as a whole there is a stable demand for workers. Mobility between jobs plays a decisive role and it is a requirement for the existence of optimal mobility between firms that no constraints exist. In this market there are no differences in job-contents between occupations and it is important that no worker gains firm-specific qualifications because this would lead to a decline in the optimal functioning of the market. Qualifications must be obtained outside the firm and across the trade according to certain standards regarding the broadness and level of skills. These have to be secured through formal procedures aiming to secure internal allocational flexibility. The allocational and the gratificational structures may be institutionalised, but such institutions need to be organised for the market as a whole or at least outside of and unrelated to individual firms.

The firm-specific sub-market is characterised by a situation whereby qualifications are specific for one firm. Important for the origin of these markets is the time-length in which the qualifications have been used within the firm because similar to physical capital the profitability of human capital is affected by the relationship between the period of utilisation and costs. To secure their investment in specific skills employers attempt to shelter the internal market by involving the employees in the return on investments thereby increasing the employees’ turnover and mobility costs. The institutionalisation of firm-specific labour markets is mainly carried out by formalising norms and the terms of negotiation between the labour market parties.

According to Lutz and Sengenberger (1974 p 71) it is in particular the firm-specific sub-market which differs from traditional neoclassical theory. They find that the unspecific sub-market can be characterised as the ideal-type labour market
described in neoclassical theory. They also find that the adjustment processes in the craft sub-market comply with the processes described in neoclassical theory because this sub-market is characterised by a high degree of transparency, low mobility costs, and wages differentials play an important role for the incentives to move. The firm-specific sub-market on the other hand does not correspond to traditional neoclassical theory. In this market wages and marginal products do not equate at every point in time and wages also depend on how costs of and returns from investments in human capital are distributed between employers and employees.

One of the purposes in developing the model was to evaluate the German “Arbeitsförderungsgesetz” (“Employment Promotion Act”) from 1969 and the measures to promote vocational training, retraining, and mobility which the act contained. Similar to the American discussions of the late 1960s and early 1970s of marginal workers and of schemes aiming at improving the integration of these workers into the labour market, Lutz and Sengenberger argue that the measures of the Employment Promotion Act have limited and conflicting effects when a considerable part of training and education is obtained within firm-specific sub-markets. Government support of firm-specific skills will lead to a decline in mobility and support of mobility - including general training and retraining - will not comply with the needs and the structures of firm-specific sub-markets. In addition to these limitations of the 1969 act, they argue that the problem in the unspecific sub-market is rather a lack of good and stable jobs than a lack of mobility and training. In conclusion Lutz and Sengenberger argued that the combination of education and mobility enhancing measures which were promoted by the Employment Promotion Act only works in craft sub-markets where educational standards secure internal mobility and flexibility.

1.2.4 Internal labour markets and trade unions

As pointed out by Rubery (1978) the Doeringer and Piore model does not systematically include an investigation of trade unions and their role in the evolution of internal labour markets. However, this can not be seen as a
fundamental objection against the theory. In further work by the Munich school both trade unions and labour market legislation are integrated into the analysis and it is pointed out that these features are important for the efficiency of the firm and for the division between internal and external markets.

Mendius and Sengenberger (1976) define the maximisation problem of the firm as a relation between stability in the product market and flexibility in the labour market, whereby trade unions and labour market legislation play an important role in determining this flexibility. As regards the internal labour force and the labour market they argue that firms try to obtain as high a degree of elasticity and flexibility as possible. Two processes are essential in this regard. First, the degree of fixity in the use of factors of production in comparison to variable factors. Second, the existence of restrictive internal and external norms: “All rules and stipulations of a contractual or legal nature which fix, hinder or increase costs of adjustments through qualitative or quantitative changes of input of factors, minimise the elasticity of the firm” (op cit. p 32). The firm will try to minimise the constraints on elasticity and flexibility which these processes causes through different measures, for example through an increase in internal mobility in the use of factors of production.

These ideas are developed further by Sengenberger (1981) with his hypothesis of a segmentation cycle. His main point is that changes in economic growth affect both the demand and the supply side of the labour market, and it gives rise to varying strategies on the part of the employers, employees, and the state. He finds that the labour market structure has changed from “covert” to “overt” segmentation during and after the economic recession of 1974-75.

Before the 1974 recession mobility flows in the labour market were generally upwards. Workers who were displaced for technological or structural reasons could quickly be reintegrated elsewhere. With the economic recession of 1974-75 and with rapidly increasing unemployment, the boundary lines between the permanent and marginal workforce became clearer. Growing selectivity in hiring and firing and uneven rates of redundancy across sectors of the economy led to the development of three classes of labour (op cit. pp 248): a “primary” labour force
with rather secure employment; a “secondary” segment of workers who are confined to cyclically vulnerable and unattractive jobs; a “tertiary” segment of the hardcore unemployed.

Sengenberger interprets these changes in terms of different employment strategies of management and labour and investigates these with the categories “strategies of inclusion” and “strategies of exclusion”. The point is that in a period of tight labour markets management is ready to pay the costs of sheltering its internal labour markets against competition from the external market in order to reduce competition from other firms for its specialised workers. Sections of privileged groups of workers are interested in protecting their privileges by excluding other workers. By contrast, in periods of slack labour markets firms try to gain flexibility by eluding the norms, restrictions and costs associated with segmented markets. Labour, on the other hand, follows the opposite strategy, seeking to reduce as much as possible both downwards mobility and the loss of jobs. The strategies of exclusion, employed by the workers within the internal labour markets, need to be seen in opposition to the strategies of solidarism pursued in the external labour markets, where workers try to gain access to jobs in the internal labour market. According to Sengenberger, the outcome of these strategies is dependent on the structure and philosophy of the trade unions.

In summary, strategies of inclusion and exclusion have consequences for labour markets firstly because they shape the distribution of flexibility in a cross-sectional and longitudinal fashion and secondly, because they have an influence on the power relations between capital and labour and among sub-groups of these classes. Sengenberger concludes that changes in economic activity and cyclical variations in the labour market structure do not move in a synchronic fashion. Instead, the labour market evolves with a time-lag due to the inertia and resistance inherent in structured relations. The structures prevent immediate changes in the labour market in response to changes in economic activity but this resistance is only temporary and relative.
1.2.5 Policy implications and adjustment processes

Several authors have pointed out the strong policy orientation of the segmentation literature, including the analysis of internal labour markets (Cain 1976 pp 1216, Wachter 1974 p 640, Freiburghaus and Schmid 1975, Taubman and Wachter 1986 p 1183). It is therefore appropriate to conclude this part of our debate by considering on a more general and analytical level what the policy implications of the internal labour market models are said to be. This is however by no means a straightforward undertaking. Since the more specific segmentation concepts were developed in “a very specific national and historical context” (Lutz and Sengenberger 1980 p 292), it is unclear the extent to which the claimed policy implications of the analyses and the empirical findings are meant to have any validity outside the particular context characterising their origin. However, two more general policy themes seem to run through the literature.

A central policy theme is the view that efficient policy intervention needs to take account of dynamic processes within the labour market. It is argued that what from a static point of view might appear to be efficient/inefficient might turn out to be inefficient/efficient from a dynamic point of view. We can identify a three-level model of dynamic change which distinguishes between i) a set of basic institutions, which are not analysed in much detail but which are assumed to evolve slowly due to basic behavioural changes and learning processes; ii) a set of institutional structures and actors (e.g. internal labour markets, trade unions) which change reactively due to changes in economic conditions and the economic cycle; and iii) the market and the business cycle itself which is assumed to lead to a harmonisation of different interests and imbalances within the labour market in the longer term.

Unfortunately, the interaction between the three levels and the related efficiency criteria are nowhere clearly defined and specified. The main point of departure from more traditional views of labour market imperfections and dynamic adaptation appear to be the claims of a very slow speed of adjustment and the existence of high costs and diverging interests connected to these adjustments. For labour market policy - the diverging policies of the employers, the employees and the state - the implications of the approach seems to be to point out the need of finding the right
The three worlds of segmentation theory

policy mix between measures aiming to deal with short term inefficiencies and adjustment processes and measures aiming to deal with more fundamental structural issues and change. Long-term programmes will only slowly succeed because they include behavioural changes and learning processes (Schmid 1980 pp 259). However, before more precise policy proposals are justified it seems necessary for internal labour market theorists to specify in more detail the relationships between the economy (especially the business cycle, institutions within the market, and the partial interests) and the labour market structure in order to be able to clarify the speed of adjustments (Doeringer and Piore) or the length of time lags (Sengenberger) as well as the appropriate policy mix.

The second policy theme which appears to run through the literature is derived in a critique of what is claimed to be the dominant and received view on labour market policy. According to the human capital theory and the traditional labour market policy of the 1960s it is the workers in the external or casual labour market who constitute a policy problem. To the extent that they are participating permanently in the labour market, their failure to build up a career is seen as the consequence of a lack of basic skills, a lack of social determination, and their abnormal behaviour (see e.g. Hall 1970 and the summary in Gordon 1972 pp 92). By contrast, internal labour market theorists tend to argue that the major labour market imbalances and suboptimal outcomes develop as a result of the behaviour of the firms and other actors within the technologically developed and efficient part of the economy.

The partial interests relating to segmentation processes in this part of the economy impose costs on society, the economy, and workers in the external market. In Doeringer and Piore’s analysis the internal labour market is shielded from external competition and according to Sengenberger the distribution of unemployment among groups of workers evolves as a consequence of the dynamics of internal labour markets and its responses to changes in economic activity. On the basis of this diagnosis a Neoliberal economists would argue that efficient government intervention would aim at crushing the rent seeking behaviour of insiders. However, Lutz and Sengenberger (1980) argue strongly against the view that their diagnosis should have any such policy implications. But what, then, the
policy implications of their analysis are is not developed in any great detail. In Sengenberger (1978b pp 53) the policy recommendations relating to the dismantling of segmentation are developed in an analogy to the improvements of a defect irrigation system in agricultural districts and more recent contributions by the authors are not much clearer.

In the American debate Doeringer and Piore argue for a combination of policies aiming at reducing barriers to entry to the primary sector and the upgrading of the employment conditions in the secondary labour market: “The search for policy instruments to redress labor market duality involves improved anti-discrimination activities, the reorganization of the secondary sector to stabilize and rationalize the utilization of manpower, and the exploration of institutional solutions to encourage the growth of primary-like employment in the secondary sector” (1975, quoted from 1980 p 430). Yet, what this implies is not specified in any further detail. For example, on the basis of the internal labour market theory itself one would predict that these clearly distributionally motivated policies would lead to an overall extension and consolidation of rigidities in the labour market. Further research both on a theoretical and empirical level would need to clarify this and the other issues debated above.

1.3 Industrialisation, dualism, and labour market stratification

As we have seen, in his joint work with Peter Doeringer from around 1970 Michael Piore viewed neoclassical labour market theory as the benchmark against which an alternative labour market theory needed to be judged. In more recent joint work with Suzanne Berger and Charles Sabel (also from the MIT), Piore develops a conceptual framework that has a much broader point of departure than a criticism of mainstream labour economics. In contrast to scholars asserting that we live in a continuous, homogeneous world, Piore argues that the fundamental view of the segmentation paradigm is that the world is “sharply discontinuous and involves heterogeneous behaviour” (Piore 1983 p 250).

The new theory of the functioning of labour markets is embedded in a wider theory of industrial societies which, in turn, is derived from a criticism of the basic
ontological assumptions of all existing social science paradigms. Together with Sabel, Piore advances a sweeping analysis of the development of industrial society which includes the development of alternative technological paths and micro- and macroregulatory frameworks, the emergence of macro-dualism and the determinants of the stratification of the labour force. A diagnosis of the current crisis is also presented. In the next section the basic points of departure of the MIT analysis is presented. In the sections that follow, Piore’s and Sabel’s analysis of industrial society is critically discussed. Piore’s labour market stratification hypothesis is debated in the final part.

1.3.1 Basic conceptual framework and points of departure

In their joint overview of their conceptual framework, Berger and Piore (1980) assert that their ideas are conceived in opposition to what they regard as the two main paradigms in American social science: the “modernisation paradigm” and the “competition paradigm”. According to Berger and Piore, both paradigms rest on the idea of a continuous progress of society and a continuous distribution of opportunities and behavioural traits within industrial societies. In contrast to these ideas Berger and Piore assert that industrial societies are segmented, develop discontinuously, vary substantially and do not develop towards convergence. On the basis of these points, Berger and Piore raise the fundamental questions: “What remains of the notions of industrialisation and modernisation? In what sense is it meaningful to think of industrial society at all?” (op cit. p 6).

Two answers to these questions are provided by Berger and Piore. Firstly, industrialisation may be defined in terms of the characteristic problems which it poses for the social structure. The two main problems are “political instability” and “economic uncertainty”. As regards the labour market, economic uncertainty and its distribution and redistribution is the underlying issue determining the shape of labour market institutions. In Berger and Piore’s analysis these institutions emerged in response to waves of worker unrest and appear to be the immediate cause of duality in the labour markets of advanced economies. Secondly, industrial society may be defined by the division of labour and the development of technology. From
this perspective, “what is common to industrial societies is a set of problems that arise from their technologies; the differences among industrial societies are the product of the process through which those problems are resolved” (Berger and Piore op cit. p 8). The problem solving process is essentially a political process and leads to a situation whereby differences between societies are as significant as their similarities. A unique and optimal solution does not exist; a wide range of solutions have been and are still viable. For example, functionally equivalent solutions may have significantly different consequences for various groups. Finally, the development of technology is not uniform across societies since cross-national variations in political instability and economic uncertainty affect this development.

Similar ideas are developed by Sabel (1982) who asserts that all existing theories share three fundamental assumptions: “technological determinism”, “essentialism”, and “reductionism”. Of these assumptions, Sabel argues that “technological determinism” is the most fundamental and troublesome because it rests on the idea that “regardless of political preferences, any society which would want to produce industrial goods must adopt certain structures of organisation, patterns of authority, and ways of doing business” (op cit. p 4). “Essentialism” is a species of determinism according to Sabel. It rests on the claims that what is true for society as a whole is true for each of its parts and that the more advanced an industrial society is, the more clearly modern forms of organisation predominate in each of its parts. According to Sabel, proponents of essentialism predict that as the differences between industrialising societies disappear, each society becomes internally more homogeneous. Finally, in Sabel’s argument “reductionism” is a doctrine stating that experience unambiguously determines thought. Reductionists argue that political ideology and moral convictions have become increasingly irrelevant during the postwar period because industrialisation produces a uniform experience of life. On the basis of these critical points, Sabel develops an alternative concept of industrial societies which seeks to answer two questions.

Firstly, what are the fundamental similarities and differences among industrial societies? Building on Piore’s idea of the division of labour and dualism Sabel finds that “the basic features of the division of labour and the segmentation of the work
force have been fundamentally similar in industrial societies through most of their histories” (op cit p. 21). Even though the structuring of the workforce can vary, there are constraints on the degree of variation. For example, all industrial societies will have to acknowledge the difference between skilled and unskilled workers but there is a good deal of free play in the way in which the line between the two categories are drawn. From a comparative methodology point of view, the existence of this basic feature of industrial society allow us to draw inferences across time and space concerning fundamental labour market structures and processes.

Secondly, what are the limits of diversity and the sources of uniformity in modern society? Sabel develops this issue in relation to import and imitation of technology from abroad and argues that industrial nations must meet the efficiency standards of their powerful competitors if their independence is to be preserved and they therefore need to copy whoever has come up with the most successful techniques. In so doing they integrate the new technology into their societies but they do it in a unique way. For the empirical analysis it is important to note that the process of imitation and individuation exhibits universal features: “To take only relatively modern examples, the industrialization of the Third World does not involve fundamentally different processes from those underlying England’s imitation of Dutch commercial techniques of the seventeenth century, French attempts to learn from English agricultural practices in the eighteenth, Latin American attempts to borrow the technique of liberal statecraft from the Old World in the nineteenth, or the Old World’s imitation of American manufacturing practice at the beginning of the twentieth century” (op cit. p 27).

1.3.2 Macro-dualism and technological progress

On the level of empirical analysis, Berger, Piore and Sabel are in the main concerned with sketching various lines of interpretation of the economics and politics of industrial societies and their evolution rather than with the presentation of new empirical material and insights. For our discussion only Piore’s and Sabel’s work are of interest. Berger’s empirical work addresses the limited issue of exploring the way in which politics and the “traditional sector” intermingle in Italy
and France. In a second contribution she enters into a renewed general debate of the various “assumptions that underlie our theories of industrial societies” (Berger 1980a, 1980b). This debate has already been considered in the previous section. Piore’s and Sabel’s work can be divided into firstly an investigation of the origin of macro-dualism and the nature of technological progress and secondly a broader analysis of the origin and impact of historical episodes on the corporate structure and labour as well as the existence of possible viable historical alternatives within contemporary industrial society.

(a) Macro-dualism in labour markets

As noted in the previous section, the three theorists argue that social groups and classes attempt to build shelters against the impact of economic uncertainty. Some groups are more successful than others, leading to a dichotomization of the social and institutional structure of the labour market. Piore (1980a) develops this hypothesis further on the basis of case studies of the impact of workers’ unrest in Italy (1969), France (1968), and the United States (1930’s).

In this work Piore wishes to resolve two critical problems in the segmentation literature. The first problem is that according to Piore most of the explanations of dualism have hitherto placed the emphasis on the demand side of the labour market. Piore now intends to include the supply side with a view to answer the question “why the jobs in the secondary sector are concentrated among certain groups of workers rather than others” (Piore op cit. pp 25-26). A second critical problem of the segmentation literature is that most empirical studies have been micro-studies of particular labour markets and industries. Piore argues that the different micro-studies of dualism show a whole range of reasons for duality but these reasons and explanations are not mutually exclusive. On the other hand, the studies have a limited reach because they do not show the reasons for dualism at the macro-level. Following these lines of thought Piore intends to develop a macro perspective on dualism, where the criteria for a macro theory are that “all of these dualistic markets lie along a continuum of arrangements in terms of the overall degree of security which they provide” (op cit. p 27).
Integrating into one analysis both the problem of the supply of disadvantaged or underprivileged groups of workers to the economy and the problem of dualism at the macro-level, Piore argues that macroeconomic dualism arises when there is a broad similarity across most of the economy on three dimensions: first, in the pressures for a division between secure and insecure jobs; second, in the particular institutions through which the division is created and maintained; and finally, in the groups that man the insecure sector.

On the basis of his empirical studies of Italy, France, and the United States, Piore draws three conclusions. First, he finds that in all three cases the division between secure and insecure jobs and the expansion of the secondary sector occurred in response to a sudden upsurge of labour militancy. Labour militancy in the three countries originated outside the existing institutional structure of the labour movement and was apparently a spontaneous expression of accumulated and suppressed discontent rather than based upon a programmatic motivated campaign.

Second, in all three cases, the institutional arrangements through which the distinction between the primary and secondary sectors is effectuated appear to be “found” rather than “made”. Institutional arrangements do not appear to be determined by the division between primary and secondary industrial sectors. Instead, it was the implementation of labour and social security legislation and the reformation of the trade unions in the wake of labour militancy which first made room for the expansion of a distinct secondary sector. Legislation and union reformation led to a rigidification in the use of labour by large firms which in turn encouraged the growth of secondary arrangements.

Third, Piore finds that the labour force for secondary jobs tends to rely heavily, although not exclusively, upon preindustrial groups and classes. The capitalist system finds these classes and does not create them. Piore argues that in all three countries migrants, rural workers, and women are attractive for certain groups of employers because they belong to another socio-economic structure and they view industrial employment as a temporary adjunct to their primary roles.
(b) The nature of technology

In the view of the three theorists, the underlying dynamics of industrial society derives from the development of technology. Piore delivers a more explicit definition of technological progress: “Technological progress consists in dividing up the productive process into its component parts and then attaching those components one by one to other operations where they are governed by a different and presumably more efficient logic” (Piore 1980a p 23). This progress is not continuous for two reasons: First because of the nature of technological progress itself. Piore argues that the process of specialisation, which is associated with the development of technology, is the critical point in economic growth, and he points out that it is “critical to the intellectual process through which more productive techniques evolve” (Piore 1979 p xiv).

One of the consequences of the intellectual problems in developing a more efficient technological logic is that a residue of older operations which cannot, or cannot yet, be reassigned is left behind (Piore 1980b). Second, progress is discontinuous and dualist structures develop because of uncertainty and instability in demand in the product market and because some older and more labour intensive techniques are more profitable than more specialised techniques. The degree by which output can be standardised is also important.

The relationship between technological progress and the political and sociological structures can be described in two distinct ways. First, there exists a hierarchy of techniques which require different kinds of learning. The location of a job in the labour market structure depends on the number of tasks it is composed of and the relationship between these tasks (Piore 1980b p 69). Second, the political and technological dynamics do not run in parallel but stand in a complex relationship to each other. According to Piore, the division of labour and flux in demand might lead to the development of two distinct economic sectors operating with different technologies and different organisational structures but the two sectors might not necessarily operate with two distinct groups of workers and political dynamics (Piore 1980b p 79).
1.3.3 The evolution of the large primary sector corporation: Historical episodes and alternatives

Piore’s analysis of technology and the role of fluctuations in product demand and Sabel’s historically informed analysis of the division of labour in industry are combined in a more recent sweeping analysis of the development of industrialism and the modern primary sector corporation since the industrial revolution which also includes collaboration with Jonathan Zeitlin (Piore and Sabel 1984, Sabel and Zeitlin 1985). Even though Piore, Sabel and Zeitlin only refer to these debates in footnotes, their analysis appears also to be strongly influenced by discussions since the mid 1970s in evolutionary biology of Stephen Gould’s (1977) critique of the gradualist “Darwinian” model of evolution and his alternative “punctuated equilibrium” model, whereby evolution is concentrated in sudden and relatively rapid events of change and speciation as well as by discussions relating to Roberto Unger’s (1987) more recent thoughts on historical alternatives and “false necessity”, in which he emphasises the fortuitous origin and high fragility of current institutional premises. Stephen Gould and Roberto Unger are both professors at neighbouring Harvard University - Piore, Sabel and Zeitlin refer to a draft version of Unger’s book.

(a) Historical episodes and alternatives

Piore and Sabel argue that in order to understand the choices we face today, the choices that were made in the past must be clarified (op cit. p 4). They insist that we most depict “the distant origins and hidden logic of current economic practice” (op cit.) and we must conceptualise “a world that might have turned out differently from the way it did, and thus a world with a history of abandoned but viable alternatives to what exists” (op cit. p 38). With regard to the evolution of industrialism, “in the world of possible worlds, relatively short periods of technological diversification punctuate longer periods of uniformity” (op cit. p 39). Piore and Sabel call these brief historical moments “industrial divides” (op cit. p 5). Industrial and political development is more appropriately circumscribed by the metaphor of a “zigzagging path” in contrast to the traditional “narrow track” view of historical development.
argued by classical political economy. Economic development reflects politics. The choice of direction at these crucial moments in history is essentially determined by political forces but once a particular economic system has been created in a specific historical situation, the distribution of power between the key actors is frozen for a long period of time (op cit. p 277).

In past work Sabel used the catchphrase “fordism” to characterise the dominant mode of industrial development during the twentieth century (Sabel 1982). In the more recent articulation of the theory Piore, Sabel and Zeitlin talk instead of the development of “mass production” in recognition of the wider range of production strategies that have prevailed during the last century or so than the particular one developed by Henry Ford and his company. In the opening paragraph of their article, Sabel and Zeitlin offer a concise definition of “mass production” as “the combination of single-purpose machines and unskilled labour to produce standard goods” (Sabel and Zeitlin 1985 p 133, see also Piore and Sabel 1984 p 4). Mass production has as its correlate mass markets for standardised goods which are general in nature and can be put to a variety of uses (Piore and Sabel op cit. p 27).

In line with their view of history it is argued that the current mass production mode of industrialism came into being during the “first industrial divide” as the result of some “implicit collective choice” (Piore and Sabel op cit. p 5, Sabel and Zeitlin op cit. p 134). Craft production - defined as skilled workers’ use of “sophisticated general-purpose machinery to turn out a wide and constantly changing assortment of goods for large but constantly shifting markets” (Piore and Sabel op cit. p 5) - is the mirror image of mass production. It lost out and was largely abandoned during the first industrial divide, not because it was not efficient and a viable mode of production, but because of historical circumstance.

In its origin current mass production was the upshot of a “blind decision” which emerged out of the peculiar historical setting of the nineteenth century. Yet once it was invented, it became the dominant mode of production and a “destiny” for others to follow. Even though it can not be said to have constituted the optimal solution to the efficient production of commodities and economic growth, dominant firms and powerful interests forced the new mass production principles on competitors:
“competition guarantees only that the weak must follow the lead of the strong, not that the strong have found the uniquely correct solution to common problems” (Piore and Sabel op cit. p 15). What is more, the very scale of success of mass production began to shape the presumptions and mindsets of actors, including practitioners who had previously been sceptical and even opposed to this particular mode of production. Mass production developed into a new “technological paradigm” and orthodoxy that was not and could not be questioned (op cit. pp 44). Having won out in the realm of practice it next won out in the realm of ideas obscuring the vision for alternatives in the process.

Also the prevailing pattern of macro- and microregulation emerged as the result of peculiar historical episodes and events. The American system of macroregulation was established with the New Deal in the 1930s and emanated as the residue of the successive but uncoordinated introduction of diverse programs (op cit. p 92). At the micro level, the modern corporation was the logical consequence of the evolution of mass production and was organised with the purpose of meeting the need for microeconomic regulation and coordination (op cit. pp 49). American shop floor control and industrial relations on the other hand evolved as the result of a series of “accidental combinations” which began with a number of rather limited decisions in the 1920s. The system gained further impetus by the New Deal legislation before it was finally solidified in the 1950s (op cit. p 113). With the imposition of these microregulatory arrangements, the internal labour market system was born. During the postwar period the related wage setting system became the keystone of the whole system of macroeconomic stabilisation (op cit. pp 79).

Finally, in Piore’s and Sabel’s conception, the current economic crisis surfacing during the 1970s is likewise the product of a series of fortuitous, historically contingent events, accidents, external shocks and critical episodes (op cit. chapter 7). The crisis has been aggravated by policy mistakes bred by a false understanding of the underlying institutional structure and policymakers’ failure to develop an enlightened crisis management strategy (op cit. p 166). Amongst the mistakes were policymakers’ efforts to control inflation and to enhance wage and price flexibility
Instead of resolving the problem, these efforts increased uncertainty, instability and confusion according to Piore and Sabel.

A second, more structural factor causing the contemporary crisis is the saturation and break up of mass markets leading to a decline in the viability of mass production, productivity growth, and new labour hires. This structural trend is linked to the changing macro-economy in that the economic crisis and the related increase in uncertainty has reduced the stable component of product and consumer demand rendering mass production less profitable. We now find ourselves in the midst of the “second industrial divide” where the existing mode of production is being challenged and transformed and a new paradigm and new strategies are being sought. Technologies, markets, and hierarchies are in flux, assumptions have ceased to hold, the familiar has suddenly become mysterious, and the confusion is fundamental and widespread: “The stakes are high. Prolonged confusion in the advanced world increases the risk of international economic collapse” (op cit. p 7).

One desirable strategy out of this state of affairs would be to depart from the existing mass production principles and to revive the craft principles of the nineteenth century by promoting new forms of flexible specialisation - defined as a form of permanent product and technological innovation by speciality firms and small enterprises. The implementation of this strategy would connect with current changes in consumer demand, especially the increase in the demand for speciality products, and with current changes in technology, including the increased use of computers, but it would require the constitution of new micro- and macroregulatory institutions based on solidarity and communitarianism (op cit. pp 273-278). Piore and Sabel see signs that in recent years prosperous parts of Italy, Germany and Japan have been moving down the right path but this prosperity and the emergence of new industrial winners in these places has not been the result of the pursuit of an explicit and articulated strategy but rather of “fumbling hunches” that were rewarded with success. “Success was surprising to the successful” (op cit. 206, 223).
(b) Empiricism and substantive points

A major source of ambiguity and difficulty in assessing and discussing Piore’s and Sabel’s substantive points and empirical arguments arise from the fact that - as they themselves admit in the context of their discussion of the economy in crisis - they pose too many answers and raise too many questions (op cit. p 192). The analysis aims to synthesise on a meta-historical level very disparate empirical literatures in a wholesale examination of the evolution of industrial society and to provide evidence to suggest alternative paths society could have taken in the past and can take in the future, with the point in bringing all this together being that society consists of independent and separate but interacting subsystems and policy fields that evolve in a complex, incongruent, and discordant manner. The analysis is certainly not “essentialist” and “holistic”: society’s “parts” can not be derived from a conception of society’s “whole”. In applying this line of thought, the theorists provide a welcome assault on primitive chronological history writing which is often given analytical credence by claims of the “logical necessity” of a particular developmental path.

On the other hand, most empirical scholarship is concerned with analysis of subsystems and the various points made by Piore and Sabel relating to the developments of these systems stand out more for their familiarity than their originality. For example, Piore’s and Sabel’s point that American regulation developed in a sequence over a period of time from the 1930s to the 1950s and was shaped by various power struggles and events such as World War II rather than by an initial master-plan will not surprise anyone familiar with the literature. Similarly, that the current economic crisis is the product of external shocks aggravated by confusion and uncertainty about the appropriate policy response is also familiar territory, though most specialist scholars would probably call into question Piore’s and Sabel’s particular views of what all this exactly mean and imply.

What is more, the authors are at pains at highlighting and criticising the assumptions made by other approaches and analysts but fail to reflect on their own rather limited disciplinary backgrounds in social history research (Charles Sabel and Jonathan Zeitlin) and a particular kind of labour economics (Michael Piore) and
also fail to discuss and clarify the limits of their own conception of “alternative history” analysis. What is true for social history research is not necessarily true for the whole of the social sciences and all historical research. Many of their methodological and meta-analytical criticisms might appear justified from the distinguished point of social history research which is notorious for its lack of theory and analytical framework but their assault on the social sciences as a whole appear both misplaced and counterproductive with respect to their substantive research aims and interpretations.

Analysis of viable alternatives is not as novel as the three theorists pretend it to be. Counterfactual analyses are at the heart of mainstream economic research where questions such as how does a world of “perfect competition” compare with a world of “institutional regulation”, “monopolistic competition” and so on and so forth are dealt with in any introductory textbook. Similarly, economic and innovation cycles have been discussed in the literature since the 1920s by Kondratieff and Schumpeter amongst others but in spite of its obvious relevance for the points at issue also this literature is ignored by Piore, Sabel and Zeitlin. All serious empirical scholars discuss alternatives such as how the American macroregulatory principles might have looked like if the courts in the 1930s had had less power or would have acted differently. There is a vast literature which is largely ignored by Piore and Sabel debating the extent to which the great depression in the 1930s could have been avoided had policymakers pursued a different macroeconomic policy. Obviously, if this literature is correct, the pursuit and implementation of a different, alternative policy would have meant that the world would have turned out differently from the way it did, which is the issue Piore and Sabel say they want to conceptualise.

The authors spontaneously seem to know and reflect on the limits of their analyses and phrase the possible alternative paths in terms of what “may have” happened or could “probably” have happened but without pursuing the implications of these points in much further detail (op cit. p 16). Other central alternatives are left open in rhetorical phrased questions: “Is it hopelessly farfetched to imagine, for example, that if the Iranian revolution and the second oil shock had occurred five years later than they did, the reflationary policies of the late 1970s could have
produced a half decade of prosperity - and given world leaders the time, confidence, and resources to create international mechanisms for balancing supply and demand?" (op cit. p 193). But an explicit recognition and debate of the difficulties associated with the analysis of viable alternative paths and of the basic fact that we do not know what might have happened if alternative decisions had been taken at some decisive point in the past is nowhere to be found in their writings. Hence, in spite of their various announcements of advancing an alternative and more advanced type of analysis, in central places they do not move beyond the sort of general reflections and speculations that are common in historical and many other types of research.

The greatest ambiguity, however, concerns their main argument about the expansion of mass production at the expense of craft production in the wake of the first industrial divide in the early and mid nineteenth century. Their own evidence calls into question the extent to which the mass production mode of production that they analyse has ever existed, when they quote figures from the “American Machinist Magazine” highlighting that in the 1970s in the central metalworking sector approximately 70 per cent of all production consisted of small batches (Sabel and Zeitlin op cit. p 137, Piore and Sabel op cit. p 26). This figure refers to the United States, which according to the theorists is the mass production economy par excellence. Obviously, such data do not lean much support to the claim that mass production technology has dominated since the first industrial divide. The theorists try to save the argument by claiming that speciality production has been a mere appendix to the mass production sector but do not provide any evidence for this beyond rhetorical argumentation.

A mainstream scholar would have expected that the said finding would have encouraged the theorists to undertake a more thorough and critical data analysis using the vast amount of available data on industry and market structures which are readily available. This would of course have required scholarship beyond the reading of a popular magazine such as the “American Machinist” and the recycling of one piece of information and one figure. In light of their many claims and criticisms of other approaches the very least one would have expected is that they
would have taken issue with the basic insights of introductory industrial economics relating to the analysis of industrial and market structures (Devine et al 1979 chapter 2) and the related points debated in the literature on the “dual economy” (Averitt 1968). This would have provided the basis for a much richer understanding of the dynamics of the industrial structure than Piore’s, Sabel’s and Zeitlin’s simple dichotomy between mass and craft production as well as a better understanding of current trends in this structure.

A similar degree of ambiguity concerns their concept of industrial divides and the epochal changes that are associated with these divides. As we have seen, the first industrial divide is dated to the early and mid nineteenth century. But in their historical narrative they tend to argue that mass production was only fully established in the 1960s. Not many would conceptualise a process that lasts almost 150 years as a “short period of technological diversification”, which is what they say characterises an industrial divide. What is more, contrary to their own paradigmatic statements, their empirical exposition tends to substitute a “logic of mass production” for the Marxist “logic of capital”. Once the logic of mass production was instituted at the beginning of the nineteenth century, it was just a matter of time before it would celebrate its victory around the globe. In places it is argued that all evil is caused by mass production, be it the depression of the 1930s, which the authors say had its fundamental cause in the structural fragility of the mass production economy (Piore and Sabel op cit. p 75) or the current economic crisis.

Finally, the very logic of their argumentation is basically unclear. Above I have tried to summarise the logic of their argument as presented in Sabel and Zeitlin (op cit.) and Piore and Sabel (op cit. chapter 2). In these places the argument is clearly that exogenous rather than endogenous forces were the basis of the decline in the role of craft production, in that craft production was at least as efficient as mass production. It was the unfavourable environment which craft production had to contend with that blocked the craft model of technological development (see also in particular chapter 2 p 37). But elsewhere the line of causation is turned on its head: “In the historical record presented in chapter 2, systems of flexible specialisation
run a high risk of stagnating technologically” and craft producers need to close the efficiency gap between themselves and the mass producers if they are to expand (Piore and Sabel op cit. p 263, p 193).

Basically, if these statements are true, Piore, Sabel and Zeitlin do not have a point to make because the literature they take as their point of departure and vehemently criticise states that mass rather than craft production expanded because it was the superior and more efficient mode of production. In other words: there was no craft alternative. An alternative interpretation of the three scholars’ line of argumentation would suggest that industrial society’s concern with economic growth is itself a product of the mass production mode of production. If this interpretation is true, it would have been helpful if the authors would have stated clearly that the alternative society they envision could have developed in place of the actual developments is one with a gross domestic product pitched at a substantially lower level than what currently is to be found. A final interpretation is that the three scholars disagree on the most basic points at issue. Michael Piore’s theory of technological evolution seems to suggest that secondary sector firms are technologically backward (see point b above) while Charles Sabel and Jonathan Zeitlin seem primarily concerned with pressing the point that the mode of production that characterises this sector has constituted a viable alternative to mass production which, however, has been hindered in flourishing because of politics and other factors.

1.3.4 Labour market stratification

As we have seen, Piore and collaborators argue that the labour market in industrial societies is segmented. It is argued that the labour market is stratified discontinuously and that labour market segments are qualitatively different. In a series of papers from 1970 onwards and quite independently of his joint work with Peter Doeringer and Charles Sabel, Piore has developed a stratification model which distinguishes between three labour market segments: a primary sector upper tier labour market segment, a primary sector lower tier labour market segment, and

Similar to other works by this group of scholars, Piore is here mainly concerned with sketching ideas rather than conducting and reporting actual empirical work. Piore’s theoretical point of departure is that in spite of its intuitive appeal to manpower practitioners and academicians the dual labour market hypothesis has not “lent itself readily to the organisation and analysis of existing labor market data and has thus tended to frustrate rigorous empirical examination” and that he aims to represent “an attempt to expand and clarify the initial hypothesis with a view toward overcoming these limitations” (Piore 1975 p 125). In more recent work he has developed his ideas further and represented what he calls an “expanded concept of labour market stratification” (Piore 1980).

Piore’s basic point is that in segmented labour markets “the qualitative differences are such that both the behavioural characteristics of the principal actors (workers and managers) and the nature of human experience vary from one segment to another” (Piore 1980 p 16). Class subcultures shape the supply of labour to labour market. However, the skills and behaviour which the jobs require and the nature of labour demand can reinforce and interact with the characteristics which the worker had before entry into the labour market segment. Four factors are important for labour market segmentation and stratification:

(a) The first and also the most decisive factor is variations in the workers’ employment stability, which in turn is a derivative of the subculture the worker belongs to. According to Piore, it is generally their inability to show up for work regularly and on time that bars secondary workers from primary sector jobs. (b) The second factor is „statistical discrimination“. He finds that hiring decisions are generally made on the basis of a few readily (and hence inexpensively) assessed traits such as race, demeanour, accent, educational attainment, test scores, and so on. (c) The third factor concerns social experiences on the job and the reinforcement of these experiences through living among others whose life-style is adjusted to that type of employment. For example, by working in a world where employment is intermittent and erratic, one tends to lose habits of regularity and punctuality. (d)
The fourth factor is the public assistance system and the relationship between social workers and clients. Public assistance systems discourage full-time work and forces those on welfare into jobs which are either part-time or which pay income in kind. What is more, the relationship between social worker and client builds upon the personal relationship which operates in the secondary sector rather than the institutional mechanisms which tend to operate in the primary sector.

The more recent “expanded concept of labour market stratification” links his points about technology with points about learning processes, cognition and the interpretative framework of humans. Piore argues that it is necessary to gain an understanding of these processes if the segmentation hypothesis is to be developed into an alternative and comprehensive theory (Piore 1983). His basic idea is that “the list of distinctive behavioural characteristics which define the strata are generated by a single, basic, underlying difference, that is, a difference in the way in which people learn and subsequently understand, the work which they perform” (Piore 1980 pp 17-18). People can engage either in abstract or, alternatively, in concrete learning. Abstract learning leads to an intrinsic and concrete learning to an extrinsic understanding of job operations and the work situation. With these points in mind, we can summarise Piore’s three tier stratification model:

The primary sector upper tier of the labour market is composed of professional and managerial jobs. Work requirements in this tier includes the capability to manage new job-situations and of abstract thinking. Inhabitants of this tier need to exhibit an intrinsic understanding of the logic of technology and formal education is typically required prior to employment. Upwards mobility is a basic motivation but it does not follow rigid rules and often includes changes of firm and residency. In other respects, jobs in this tier generally provide substantial job security. The market but also tradition is an important determinant of allocation and remuneration - prestige, pay, and status are substantial. The segment connects with middle class subcultures that also provide the main source of new recruits. Internalised codes of behaviour substitute for rigid work rules and hierarchical supervision.

The primary sector lower tier of the labour market consists of blue and certain white collar jobs. Work, skills and social manners are based on routines and often
learned on-the-job. People learn the particular operations directly and they mentally organise them in relation to spaces which are extrinsic to the operations themselves. The market plays only a minor role in remuneration and allocation. Trade unions have an influence as have the internal rules of firms. Employment conditions are stable and upwards mobility follows the firms’ internal seniority rules. Over the course of life, there are certain opportunities for advancements up the ladder towards higher wages. Entry is based on “statistical discrimination” and women and ethnic minorities are generally excluded from these jobs. The segment links with working class subcultures and has as a prerequisite that workers exhibit a routinized life-style and have stable relationships with friends and the social environment.

The secondary sector of the labour market provides low skilled jobs. Work is characterised by a lack of coherence and the employment conditions and work operations are so unstable that they are difficult to memorise at all. Only basic human knowledge shared by virtually all adults is required. The market determines pay and allocation, especially by excess supply but social benefits and minimum wage rates also have an influence. Working conditions are poor and the social status demeaning. Entry requirements are low and there are no mobility chains in this segments. Workers engage in frequent job changes with unemployment or temporary exits from the labour market between each job. The segment is related to lower class subcultures. Most workers are women, adolescents, peasant workers, or temporary migrants who derive their principal identity from social roles outside the work place. Relationships between workers and supervisors are often highly personalised and subjected to few restrictions and formalised procedures. Workers are typically unstable.

1.4 Industrial structures, labour market structures, and inequality

A general feature of the segmentation theory of the Labour Studies Group (Christine Craig, Elisabeth Garnsey, Jill Rubery, Roger Tarling and Frank Wilkinson, Department of Applied Economics, Cambridge, UK) is that it interrelates analysis of the labour market structure with analysis of the industrial
structure. The group also emphasises that institutional structures have an important impact on economic developments and that it is vital for studies of the labour market to analyse the complex interplay between social, political and economic forces (Craig et al. 1985). In a general characterisation of their approach they argue that “bargaining among groups rather than individual competition emerges as the most prominent feature of labour market segmentation processes” (Garnsey et al. 1985 p 41).

In what follows the main views of the Labour Studies Group concerning the operation of labour markets are first sought summarised. These views are developed in a sometimes rather emotional critique of neoclassical economics and around the question about how inequalities in opportunities and wages emerge within the labour market. Next we concentrate on their empirical analysis of the relationship between primary and secondary industrial sectors and the allocation of workers to the secondary sector. Finally, we briefly discuss the groups’ views relating to labour supply and some of their suggestions for labour market policies.

1.4.1 Basic conceptual views: Inequalities in the labour market

In contrast to what he sees as the neoclassical barter view of economics, Wilkinson emphasises that the central issue of economics is the creation and distribution of wealth (Wilkinson 1983). Even though neoclassical theorists recognise labour market imperfections, these are only assigned marginal importance because it is assumed that in the longer term the market adjusts to the competitive norm. In contrast to this view, Wilkinson and his collaborators assert that the labour market does not adjust to purely economic and competitive forces even in the longer term as non-competing groups are composed and decomposed in a dynamic process. Following these lines of thought, the Cambridge group argue that any attempt to approach investigations of the labour market from an equilibrium point of view will fall short in analysing the complex interplay between the various forces determining the structuring and dynamics of labour markets. On the theoretical level, segmentation analyses “underline the unsuitability of any notion of equilibrium” as the basis for the analytical framework - instead a dynamic non-equilibrium
The labour market functions in more or less the diametrically opposite manner than asserted in neoclassical wage theory. According to Craig et al (1985) and Wilkinson (1987 p 168) this theory assumes that the market operates to allocate “scarce means to alternative uses” and the theory rests on three assertions: (a) labour is a scarce resource, (b) individuals are inherently unequal, and (c) they are free to compete for a wide range of jobs. In opposition to these views the Cambridge group states the following assertions which represent their basic view of the segmentation perspective: (a) labour is in more or less abundant supply but workers have different access to employment, (b) its usage is demand constrained and workers have different access to jobs, (c) in terms of the requirements of the vast majority of jobs, workers are intrinsically equal, and (d) wages do not primarily depend on qualifications, abilities, and skills.

Structures of inequality and discrimination are obtrusive in the labour market according to the Cambridge group. The labour force is stratified by class, racial, national, religious, sex and many other factors and these divisions are created and reinforced by discrimination, differential access to education and ratified by social beliefs and conventions. Inequalities are partially offset by the welfare state but in other respects welfare state policies reinforce divisions in the labour market. Labour demand operates largely independently of supply. Job structures, pay structures and job opportunities are largely determined by industrial characteristics such as product market conditions, institutional structures and techniques of production. The characteristics of workers have little influence on the ratio of “good” to “bad” jobs (Craig et al 1982 p 65). In opposition to the idea of the human capital tradition that low wages are caused by the low quality of the workers, the group emphasises that “the important features of segmented labour markets are that relative wages are no guide to relative skills or productivity and that workers of equal skill or potential ability are employed at widely different wage levels” (Craig et al 1985 p 114).
1.4.2 Primary and secondary sectors and labour markets

The Cambridge group’s more positive and detailed view of the labour market is developed in the context of an empirical study of the effects of the abolition of the British Wages Councils system and a debate about the extent to which trade unions can replace these councils in protecting low paid workers against exploitation. In more general terms the study is investigating the impact of institutional changes on the lower tiers of the labour market, where the institutional change may be defined as an abolition of selective policies to protect low paid workers, and the possibility of an extension of alternative institutional arrangements, especially trade unions, to the lower tier of the labour market.

More specifically, the group aims to address four questions whereby three refer to the demand and the fourth question refers to the supply side of the labour market: (a) How far are the problems of low pay and inadequate collective bargaining associated with the maintenance of secondary industrial sectors or the failure to establish primary employment conditions within “primary industrial sectors”? (b) To what extent are the constraints on the establishment of primary employment conditions economic or institutional? (c) How important and how resilient are the secondary industrial sectors and how strong is the possibility that the low-pay problem will disappear along with the “remnants” of competitive capitalism? (d) How are the selection processes allocating certain groups of workers to secondary jobs organised and what are the determinants of the system of social reproduction?

Craig et al approach the questions by utilising a two-sector model of the labour market (Craig et al 1980 pp 91, 1982 pp 65). It is emphasised that the definition of “primary and secondary employment conditions represent ideal types or ‘poles’ between which industries, firms and jobs are ranged according to the employment conditions they provide” (Garnsey et al 1985 p 41). In their empirical studies the group has primarily analysed the employment conditions on the level of the firm and they have exploited what they call a “grass roots” approach (op cit. p 42). This approach involves questioning managers about their employment practices and pay policy and employees about their work.
(a) Primary and secondary sectors

The Cambridge group defines the two sectors in the following way: Primary sectors offer high wages, secure employment and formalised grading structures. The firms or industries which form the primary sector are large, capital intensive, use up-to-date technology and enjoy stable product markets based on market control. These firms are usually unionised and engage in company and plant level bargaining. Secondary sectors offer low wages, insecure employment prospects, and informal payment structures; minimum rates are determined either by the market or by some system of regulation at industry level (minimum wage laws or national voluntary collective bargaining agreements). Firms in the secondary sector are small, traditional, use traditional labour intensive technology, and are subject to competitive product markets which are often in decline or cyclically unstable. Unionisation is weak, and there is little local bargaining.

Before we turn to a debate of their concrete findings, it is important to assess and disentangle the analytical status of the group’s two sector distinction. In a simple two sector model it is assumed that all dimensions that are included in the model relate to and will ultimately reinforce the division of the economy and the labour market into two sectors. By contrast, the main point which the Cambridge group appears to wish to make by referring to “ideal types” is that the various dimensions interact in a complex interplay which demand a multi-causal analysis (see also Rubery and Wilkinson 1981).

The two sector distinction shall help in guiding and structuring the group’s empirical studies of the different firms, including the interpretation of the findings and the assessment of the design of the right mix between general and selective policy responses. But the distinction between sectors is only important as a first approximation and the sectors are not thought to exist in the real world. By assessing their concrete empirical case-study findings against the ideal types, the group wishes to clarify how the various dimensions which is included in the two-sector distinction have an influence on the development of employment conditions and pay. The group also aims to examine which of the diverse dimensions have the
strongest impact on low pay and the extent to which a policy against low pay needs to follow sectoral, industrial, occupational or national lines.

Implicit in their distinction we can detect seven factors which the group feels are having an impact in diverse ways on employment conditions and pay: 1) firm size, which is used as an important statistical indicator; 2) the technological structure, divided into modern and capital intensive, on the one hand, and traditional and labour intensive, on the other; 3) the nature of the product and competition in the product market, where a distinction is made between stable, fluctuating, and declining demand; 4) the labour process and the development of technology, which relates to social and technical constraints; 5) trade union organisation and/or legislation (for example Wages Councils), which include the question of national and local agreements and selective and general policies; 6) the organisation of employers in an industry which both affects competition in the product and in the labour market; 7) finally, the supply of workers who are willing to or forced to take low paid jobs.

While firm size and the techniques of production constitute the sectoral dimension of the model, the nature of the products and changes in demand make up the industrial dimension as this is traditionally defined. The occupational dimension is determined by the labour process and the social relations of the firm. Trade unionism are important both with regard to the need for legislation to protect low paid workers, but also because they have an influence on the development of technology and the size of firms. The organisation of employers within an industry is important for the development of competition and, then, the ability of the individual employer to pay higher wages. Technology and the labour process are significant dimensions for the investigation of technological constraints on segmentation (for example outwork), but also for the exploration of the social relations of production and the workers’ control over jobs. Moreover, the factors are also important for the examination of the relationships between jobs, skills, and pay. The supply side of the labour market is important for the investigation of those workers who man the bad jobs and the distribution of opportunities and pay among
different categories of workers (mainly male, female, juveniles). With these points in mind, we can now turn to the more specific findings of the group.

(b) Primary and secondary sector firms and employment conditions

The group’s empirical investigation (Craig et al 1980, 1982) is based on case-studies of five manufacturing industries (jute, cutlery, paper box, stamped or pressed metal-ware, baking) and one occupation (industrial and staff canteens). In their case-studies of the industries, Craig et al (op cit. 1982 pp 65) found that only in some industries primary sector characteristics had emerged and that the development of primary industrial characteristics do not provide a guarantee for the development of primary sector employment conditions and pay as other factors than the sectoral division play a considerable role.

In the jute industry primary sector employment conditions emerged without much trade union involvement. The evolution of these conditions was mainly due to the introduction of new methods of production. In stamped or pressed metal-ware only a few firms corresponded to the primary sector characteristics as simple traditional machinery was used and subcontracting predominated. Within a small number of large firms engaged in mass production effective local bargaining had been established. Although both cutlery and baking had sectors with modern mass production technology, no primary sector employment conditions had emerged, mainly due to the absence of company-level bargaining and the strength of external competition in the product market. Finally, even where the main labour force enjoyed primary sector employment conditions, parts of the labour force - especially canteen workers - were subjected to secondary conditions.

In summary, the findings of Craig et al suggest that in addition to industrial characteristics the nature of product market competition and the institutional structure of an industry are important determinants of conditions of employment and pay. As regards the institutional structure both the historically-determined system of organisation among employers and the development of unionisation and collective bargaining are important factors. While the organisation of employers is important for the regulation of the conditions of competition in the product market,
unionisation and collective bargaining are important for determining the conditions within firms. Thus Craig et al (op cit. p 69) find that unionised firms tended to move into the automated higher volume market and unionisation was clearly a factor encouraging firms to seek new markets and reduce costs through mechanisation.

In addition to the economic and institutional factors within primary industrial sectors, the presence of the secondary sector itself has a considerable influence on employment conditions and pay. Following Craig et al secondary sector firms can establish a basis for long-term survival as they provide important complementary services to the core economy and many secondary firms manage to compete very effectively, particularly during cyclical downturns. What is more, the prospects for the development and survival of secondary industrial sectors depend on their fulfilling one or more of a variety of roles in the industrial systems (op cit. 1982 p 69-70). Secondary sector firms may (i) be complementary to primary sector firms by providing services or products not otherwise available; (ii) be competitive with primary sector firms in the same product market; (iii) subcontract for primary sector firms and thus form an integral part of the primary sector production or marketing process. Based on their empirical case-studies the group draws three conclusions as regards the prospects of secondary sector firms.

First, secondary industrial sectors have long-term survival potentials, both because of the links with primary industrial sectors but also because they provide important services to industry and consumers. These links with the primary sectors are not stable as primary sector firms can use their market power to shift risks and instability to second sector firms - for example in response to a decline and changes in demand.

Second, secondary industrial characteristics are maintained by the system of industrial organisation. Secondary sector firms survive not only because they were able to carve out a permanent market but also because of general obstacles to changes in methods of production within the industries. Moreover, although technology within secondary sector firms remained traditional, it was not stagnant as numerous examples were found of firms using new forms of mechanisation on a
piecemeal basis while still continuing to use traditional techniques or labour intensive methods for some processes.

Third, the secondary industrial sectors are often subject to severe competition which encourages the payment of low wages as firms struggle to compete by reducing prices and/or fixed employment costs. Following Craig et al low wages may be the result either of unregulated wages within an industry or of product market constraints on the industry’s pay level. These two causes are interrelated, in so far that in industries under competitive pressure wages are more difficult to regulate, and the weaker the degree of organisation among employers and workers the lower the level of pay that can be enforced.

(c) The labour process and employment conditions

According to the views of the Cambridge group, conditions of employment and pay are not only determined by the sectoral and industrial dimensions. They are also determined by the labour process and the social relations of production. The group develops their own views on these issues in a critique of the neoclassical hypothesis that skills and abilities determine pay and earnings and in a critique of the Marxist hypothesis that conditions of employment are determined by the evolution of control by management over labour.

In opposition to the neoclassical views they argue that if one shifts the focus from the demands made on workers in learning jobs and instead concentrates on the continuous demands made when performing a job, then it becomes clear that demanding work is often not high but low paid (Craig et al 1982 pp 93-94). In opposition to the Marxist hypothesis that the development of capitalism shows an unilinear tendency towards the extension of control and deskilling, the Cambridge group suggests a more complex analysis which includes the success of workers in resisting the extension of control. The neglect of this issue is not only confined to Marxists. In a broad critique of existing segmentation theories they argue that “the major weakness of segmentation theories is the failure to develop an adequate theory of worker organisation and collective bargaining to be incorporated within
an analysis of the social and economic determinants of segmentation.” (Craig et al op cit. p 79, see also Rubery 1978).

In summary we can identify three main factors relating to the evolution of the labour process which determine conditions of employment and pay according to the Cambridge group: (i) the ability of the workers to exercise control over the labour process, which evolves in a struggle with employers, (ii) the development of local bargaining and trade unionism which operate on the dual principle of representing the common interests of union members while pursuing policies of exclusion with respect to non-members, and (iii) the relationships between jobs and workers, where the status of the workers often determines the status of the jobs including pay and the conditions of employment.

The Cambridge group discusses the issues further around the distinction between the positions of male and female workers within labour markets and the ratio of “good” to “bad” jobs where they find that the status of workers have an influence on employment conditions in three ways. First, by a given ratio of “good” and “bad” jobs, the status of workers determines the access to jobs. Employers and workers share the view of women as secondary workers and exclude them from “good” jobs and trade union membership. Second, the status of workers has an influence on the ratio itself. Craig et al argue that in the industries they had studied the predominant influence on the shape and structure of the pay and employment system was the gender of the workers and they conclude that “jobs are not feminised because they are deskilled, but deskilled because they are feminised” (Craig et al 1982 p 84). It was common practice not to grade jobs in which women were employed and women were paid lower rates than men even when they were better qualified and did more demanding jobs. Third, the availability of workers with a weak position in the labour market may create low paid jobs and thereby have an impact on the evolution of the ratio of “good” to “bad” jobs. According to Craig et al homeworking and outwork provide examples of the payment of low wages resulting directly from labour supply conditions and not from the dictates of the product market (see also Rubery and Wilkinson 1981).
1.4.3 Segmented labour supply

The views of the Cambridge group relating to the supply of labour may be clarified in comparison with Piore’s stratification model. Similar to Piore the Cambridge group emphasises the interaction between a segmented job structure and a segmented labour supply. Workers entering the labour market face a segmented job structure and their allocation within that structure will depend on various selection criteria such as educational qualifications, sex, age, family connections, social class and the like. Also similar to Piore they stress the interaction between entry, work history and allocation in that they find that work history reinforces the position the worker had at the time of entering the labour market. However, in contrast to Piore’s model, the Cambridge model stresses more explicitly the institutional structure of the system of social reproduction and they also suggest a different diagnosis concerning how supply characteristics determine the labour market structure: While Piore emphasises the unstable work habits of secondary workers, the Cambridge group points towards their position within the system of social reproduction. Secondary sector workers are characterised by “social and economic disadvantage, not low skills or lack of work commitment” (Rubery 1987 p 80).

The theory of the Cambridge group concerning the determinants of the supply of labour is based on the notion that labour is inherently weak when compared with capital. Individual workers lack the means of production and the resources necessary to sustain themselves without the sale of labour power. They also find that customary standards of living determine behaviour in the labour market and different groups of workers have different earnings requirements (Craig et al 1982 pp 79). Following these lines of thought they find that the position of workers in the social or class structure determines job aspirations, expected standards of living, and hence minimum acceptable wage levels. Based on these principles they state four hypotheses about the relationships between, on the one hand, wage differentials and opportunities in labour markets and, and on the other hand, the structuring of social reproduction (Craig et al op cit. pp 88, and 1985).

First, they argue that the structure of social reproduction differentiate and segment the wage labour force. The family and the community allow the
withdrawal of certain classes of workers from the labour market - particularly women and children - and provide alternative sources of subsistence and mutual support. This in turn strengthens the bargaining power of workers in the labour market. One of the consequences of the withdrawal of labour from the labour market is the creation of a reserve outside the formal labour market, which is available for the “black economy”, homeworking, and low paid part-time jobs.

Second, one of the consequences of the family structure is an uneven distribution of responsibilities for family organisation. Patriarchy which forms the basis for the organisation of the family inherently weakens the position of women in domestic production. Married women who are waged workers are often secondary earners with primary responsibility for childcare and housework.

Third, the group argues that inequality in the labour market is legitimised both by the system of family organisation and by the structure of social, class, and race inequality. Differences in expected standards of living and in expectations concerning the contribution of family members to income and to domestic labour make wage inequality in some sense more acceptable, or less readily disputed.

Finally, the state is an important force in the structuring of labour supply. Much of the state’s activities can be interpreted as being in the interest of capital in ensuring the existence of a disciplined, trained and healthy labour force and in maintaining a reserve army of labour by the provision of social welfare. On the other hand, the struggle between labour and capital at the level of the state has resulted in important gains for labour. Thus one of the effects of the welfare state has been to counteract trends towards labour market segmentation, as social security has lifted the burden of poverty somewhat and education and improved health care have raised expectations.

1.4.4 Labour markets and wages policies

As we have seen, an important aim of the Cambridge group’s study of low pay and conditions of employment was to develop a diagnosis of the effect of the abolition of the Wages Councils on low pay and to investigate the extent to which trade unions can replace these councils. The motive behind the establishment of the
Wages Councils system at the beginning of this century was that low paid workers, who were not covered by voluntary collective bargaining, needed protection by the state in the form of legal minimum wages. The Wages Councils system was - and still is - set up at industry level and they fix minimum wage rates within each industry and also exercise control of the extent to which these wages are adhered to by the industry. Support but also critique of the Wages Council system has been advanced both by employers and trade unions.

The support for the system by mainstream employers has been based on the aim of avoiding unfair competition from other employers who were willing to pay wages below the going rate. The critique, which has been put forward over the last few years, was that minimum wages were too high and they were pricing people out of jobs. The support by the trade unions has been based on the argument that the Wages Councils should only be a temporary system which should help advance the development of collective bargaining in all industries and at all levels. Moreover, trade unions had to admit that they were not very successful in organising the workers within small firms and the fluctuating sectors of the economy. The trade union critique of the systems has been that it hinders the extension of trade unionism as workers do not recognise the need of joining trade unions when they are protected by the state.

On the basis of their studies, the Cambridge group argues that minimum wage protection is still necessary (see also Rubery et al 1983). However, they also find that the persistence of low pay is not only caused by inadequate institutional structures but also by industrial characteristics - especially the fragmentation of industry. Low pay persists in all areas of the economy but the impact of minimum wages on employment will be influenced by the degree of concentration of the low paid in the following areas (Craig et al op cit. 1982 p 137): (i) low-paying industries; (ii) low-paying firms in industries where pay is not generally low; (iii) low-paid occupations within all types of firms and industries. So far the group has not attempted a quantification of these features and of the impact of minimum wages on employment.
Since their study suggests that the causes of low pay are rooted in the economic and technical conditions of production and in the institutional and social structure, they find that minimum wage control could not be the major vehicle for reducing the degree of pay inequality. Instead they point towards a combination of various policies which correspond to their integrated approach to the problem and their empirical findings about the complexity of the problem. They find that “a move towards a high wage economy, from the present wide dispersion of earnings based on low productivity employment areas, can only be achieved through an extension of effective trade union organisation and collective bargaining combined with an active macro-economic and industrial policy, and cannot be effected by wage protection alone” (Craig et al 1982 p 141).

Many of the suggestions made by the Labour Studies Group have been tried out in a Scandinavian context since the beginning of the 1960’s. In comparison to England, Denmark has a higher trade union density, narrower dispersion of earnings and a minimum wage system based on egalitarian wages policies set up by the central trade union confederation and supported - at least until recently - by various governments. Moreover, in comparison to England and most other countries, the Danish industrial structure is composed of a large small firm sector which is based on high productivity and flexibility. For a further qualification of both the theory and the policy suggestions of the Labour Studies Group, it might be useful to pursue a comparison of British labour market conditions with those of other countries. Such a comparison would also reveal whether the hypotheses of the Group can be developed into a more general theory of the labour market and thus disclose the extent to which they are only applicable to British conditions.

1.5 Conclusion and outlook

This essay has debated the labour market research that has been conducted in recent years in and around the “International Working Party on Labour Market Segmentation”. Segmentation theory emerged in the United States around 1970 out of a critique of the existing labour market policies and the new trends in mainstream
labour economics towards more rigour and towards a marriage of labour economics with the prevailing microeconomic theory. While in France segmentation theory remains synonymous with the work of Michael Piore (Michon 1987 p 50), the 1970s and 1980s saw the birth of distinctive British and German approaches to the points at issue as well as a number of further works by Michael Piore and his collaborators at the Massachusetts Institute of Technology. In Germany segmentation theory is largely associated with the work of Werner Sengenberger, rather than that of Piore. For a period it ascended to become mainstream thinking on labour market structures. In Britain, segmentation theory and the work of the Cambridge labour studies group probably has had greater influence on industrial relations and sociological approaches than on mainstream economic research.

Based on conventional case-study approaches, the segmentation community has produced a great variety of empirical studies on an equally great number of issues that are hard to summarise. To my knowledge, nobody has even attempted to present such a summary. The analyses that have been debated in this essay have been chosen because their authors explicitly claim to be concerned with the development of a more general view and theory of the way in which the labour market functions. Segmentationists agree that the labour market exhibits dual or trichotomous structures. The introduction of this view is inherently uncontroversial - in empirical and nominal terms, it is obviously possible and legitimate to divide the labour market into almost any number of segments, sub-markets, or divisions that a scholar might find to be appropriate. The literature is awash with works on regional and local labour markets and on the labour market for managers, women, graduate students, unskilled workers, teenagers, migrants, and so on and so forth. It is equally clear that the presentation of a taxonomy is not the same thing as presenting and developing a theory.

The debate in this essay has therefore focused on more fundamental questions: What are the underlying analytical principles of current segmentation approaches? To what extent can the partial empirical issues that are investigated by the theorists be generalised and be developed into a comprehensive theory of the labour market as a whole? What interrelationships do the theories claim to exist between the
labour market and other parts of the economy such as the industrial structure, the structure of social reproduction, the welfare state, the business cycle, and so on? In other words: Where do these different analytical approaches lead us?

As is apparent from the debate in the preceding sections, the different research groupings provide very different answers to these questions. The entry of Europeans on the segmentation stage has increased variety but has not led to more clarity. It is fair to say that a second generation segmentation theory has not emerged and in view of the length of time the debate has been running it must be open to question the extent to which it will emerge. We are indeed facing three worlds of segmentation theory. In addition to the “time specific” nature of the initial hypotheses which David Gordon identified as a limitation in 1972, we have been granted a number of place and group specific hypotheses whereby it is hard to tell the extent to which the variations in theoretical and empirical orientation are due to national or personal idiosyncracies.

Beyond the view that “segmentation” exists there is little agreement, either on the overall aim and perspective of the analytical enterprise or on the diagnosis concerning the problem areas of the labour market. There is a world of difference between Frank Wilkinson and his Cambridge collaborators’ strong and emotional critique of mainstream neoclassical labour market theory on the one hand and Paul Osterman’s (1994 p 2) view that the segmentation literature represents an attempt of bridging the gap between human capital and other neoclassical maximizing models of the labour market and the empirical findings of industrial relations and personnel specialists on the other. Werner Sengenberger’s application of human capital theory contrasts even more sharply with the Cambridge agenda. Michael Piore’s attempt of specifying the paradigm to which segmentation theory belongs presents yet another perspective, is not particularly clear and convincing, and does not seem to have been met with much interest by other scholars in the field.

Concerns about the living and work conditions in the lower stratum of the labour market motivated much of the initial segmentation research and debate. Also in this key area we find little consensus in current research. There are worlds of differences between Werner Sengenberger’s view that in the lower stratum of the labour market
- termed the “unspecific sub-market” - allocation and gratification adhere to the norms of the competitive paradigm, Michael Piore’s view that the problems relating to the lower strataums of the labour market are due mainly to the behavioural traits and unstable work habits of workers, and the Cambridge group’s view that secondary sector employers desire worker loyalty and stability and secondary workers exhibit a high degree of work commitment.

Since none of the said scholars document the existence of comprehensive empirical material in support of their claims, these radical differences in assessment can not be said to be due to any noticeable differences in empirical research and findings but are largely due to different views of the world. In light of the fact that arguably the strongest criticism by segmentationists of orthodoxy concerns its reputed ignorance of real world phenomena and its neglect of important and overwhelming evidence relating to the nature of labour market structures and processes, the absence of empirical documentation and evidence on such a core concern of segmentationists is ironic. If the segmentation party would put aside its many battles with the mainstream world, curb its tendency to diffuse into side-issues, and instead with the help of the conventional tools of empirical research would focus on the clarification of the determinants of the conditions of the disadvantaged groups in the labour market, a new generation of productive research, building on the many interesting points and insights of the initial work, might after all stand a chance of emerging.
2. On cross-country comparisons of welfare state policies

2.1 Introduction

Most empirical research has among its aims comparisons of institutional and political alternatives. However, the majority of research only compares alternatives within the basic institutional framework provided by individual countries. In the main, comparisons are made between the workings of diverse systems, between past and present characteristics and circumstances, and between the options for reform that may exist within a given regulatory framework. Among the issues that are explored are comparisons between private and public sector institutions, comparisons of different solutions to specific economic and social problems, comparisons of different institutions of the same kind (e.g. different hospitals) or of a diverse nature (e.g. hospitals and firms). In contrast to comparisons within individual countries, cross-country comparisons of economic systems have led a somewhat isolated existence within the economics profession and cross-country comparisons of the functioning of similar institutions have almost been neglected altogether - although ad hoc references to experiences in other countries have always been part of any serious empirical investigation.

Thus little has changed since Musgrave and others stated: ““Comparative economics” has been regarded as a separate area of the economic curriculum, consisting of a botanical classification of national economies into a few loosely labelled boxes. But surely any course in economics is potentially comparative. A concern with comparative experience can profitably be infused into any standard branches of economic study” (Musgrave 1969 p v). What since then has become the discipline “Comparative Economics” is largely concerned with “grand” questions of comparing socialist and capitalist countries or comparing developed
and underdeveloped countries. But as is implied by Musgrave and others, comparative cross-country analyses ought to be part of any branch of economic enquiry.

In the last decade the issue of cross-country comparisons of state policies and institutions has been rediscovered and taken up again. Saunders and Klau (1985) from the OECD were among the pioneers with their study of the causes and consequences of the growth in government in OECD countries. More specific studies relating to the same problem include Roubini and Sachs (1989) who investigate the importance of political variables in explaining divergencies in macro-economic performance and the determinants of variations in the growth of government. In addition, questions of a more specific public choice theoretic nature have been explored, for instance by Alesina (1989), who examines whether or not governments are single-mindedly concerned with re-election. Furthermore, Burtless (1987) and later Jackman et al (1990) and Layard et al (1991) use cross-country material to investigate the effects of unemployment compensation schemes on the level of unemployment. The latter team use information from the OECD Employment Outlook which has been published annually since 1983, thereby helping to overcome an information deficit in the international research community.

More positive cross-country research on the working of unemployment compensation schemes has been carried out by Micklewright (1991) who considers the reform of unemployment compensation schemes in Eastern and Western Europe and by Atkinson and Hills (1991) who compare child support schemes in Britain, France and the United States and draw inferences from this analyses with regard to differences in social security systems in developed and underdeveloped countries. By the same token, Schmid, Reissert, and Bruche (1987), a group of German political scientists, incorporate some concepts from public finance economics in their comparison of the finance of unemployment compensation and labour market policies in a number of developed capitalist countries. Finally, and perhaps most importantly, the construction of a cross-national databank on income and its composition at the Centre for Population, Poverty and Public Studies in Luxembourg (named the Luxembourg Income Study (LIS)) (Smeeding et al (eds)
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1990) has given new statistical impetus to cross-country comparisons of social policy issues.

These and many other recent cross-country studies are concerned with a wide variety of theoretical and empirical issues and there is not one unified body of comparative research which can form the starting point for all future cross-country research. Rather, the issues of research have to be derived from economic theory and, of course, particularly from the branch of theory one is interested in.

In this paper we attempt to consider in more general terms a number of concepts for cross-country comparative analyses of welfare state institutions as well as the advantages and limitations of such research. As indicated above, cross-country comparisons are not a special branch of economics. Instead, the overall aim of comparative investigations is to test and develop theoretical and practical issues by looking at a multitude of circumstances and experiences. It is the argument of this paper that a number of theoretical and empirical issues could be clarified by using cross-country material. We are mainly concerned with state interventionism and the comparison of individual policy schemes. The overall theoretical starting point for the investigation of these issues is provided by “Public Economics” and the focus of the paper is to consider the extent to which cross-country comparisons can help develop this branch of economics.

The framework of “Public Economics” was developed in the late 1960s out of an amalgamation of two older branches of economics: welfare economics and (applied) public finance. Hammond points out that the amalgamation is benefiting both branches of economics: “Welfare economics is becoming less sterile; public finance is acquiring better theoretical foundations” (Hammond 1990 p 6). The more applied issues raised in public finance helped bring welfare theory into closer contact with practical economic issues. However, along the way important applied issues which were raised by public finance scholars have been lost and the scope of public economics is narrowed down in comparison with the themes of public finance.

Perhaps the most important issue which has been left out of public economics is comparisons of diverse frameworks towards state interventionism. For instance,
whilst Musgrave’s book on Public Finance (Musgrave 1959) is a classic his Fiscal Systems (Musgrave 1969), in which he compares the fiscal systems in different countries, is almost forgotten. As a result, the comparative research agenda has been left almost entirely to the other social sciences and in particular political science. The motivation of this paper is that the neglect of cross-country comparisons in public economics is mainly the result of limited effort and not lack of relevance.

In the spirit of Musgrave we wish to provide a theoretical framework for the examination of the functioning of economic institutions and the solution of economic tasks in a variety of settings. This implies firstly the development of a framework for the examination of the essential characteristics of diverse systems as well as the development of criteria for the evaluation of the comparative merits of the various schemes and their efficiency within their political settings (see Musgrave 1969 pp vii and pp 343). The development of such criteria includes the issues of the efficiency and equity of diverse systems as well as the extent to which it is appropriate to apply universal standards in the evaluation of policy schemes in different countries. Secondly, it implies the development of a framework for an explanation of the diverse forms taken by social security systems in different countries.

We start in section 2 with a brief examination of the main findings from political science research relating to the possible convergence of diverse policy systems and the role of the state in reproducing diversities among industrial societies. Section 3 contains a brief note on the economic approach to politics. Sections 4 to 6 investigate the welfare economic model of efficiency, market failures, and policy design. Section 7 discusses the extent to which existing notions of the welfare state provide an explanation and a justification of social insurance in the light of the fact that diverse policy solutions exist.

The next three sections attempt to develop a framework for an explanation of the diverse forms taken by social security systems in various countries, in particular the United Kingdom, Germany, and countries in Scandinavia. Section 8 considers the relationship between the “framework on choice” and “ordinary” political decisions, an issue which is considered as an argument about constitutional choice. This point
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is developed further in section 9 in which the assignment of social security provision to different levels of government is considered. Section 10 considers features of social security reform with a view to detecting how choices between institutional arrangements are actually made.

Section 11 describes the current situation regarding availability of international information on institutions and data relevant for comparative policy analyses. The section includes a detailed discussion of the multi-country studies undertaken in recent years by the OECD, as well as a discussion of recent work by Layard, Nickell, and Jackman who use OECD material. Finally, in section 12, we conclude by summarising the main points of the paper.

2.2 Convergence and divergences between policy systems

Comparative economic research of state interventionism is still in its infancy and has hitherto been investigating mainly broad aggregate issues. Little systematic economic research has been done comparing the micro-economic features of diverse public sector organisations and the design features of specific policy schemes. As pointed out by Atkinson, economists can in this respect learn something from the other social sciences: “One of the insights offered by writers from outside economics is that the role and function of income support can only be fully understood in the context of a particular society. Economic analysis is valuable because it can easily be transported across national borders and provides a common language with which to discuss problems, but it must always be applied with the aid of background knowledge of the institutions involved and how they operate on the ground” (Atkinson 1987a p 783). Hence, to establish an understanding of the characteristics of diverse social welfare schemes, it is useful to look into some of the findings of social science research.

Unlike economics, political science has a long tradition of comparative research - including investigations of the development and the functioning of the welfare state. This comparative political research pursues both a global and a more specific spatial perspective, and it is strongly historical in its orientation. However, the central themes of all this research are to detect cross-country similarities and differences in
institutional frameworks as well as to consider the related issue about the possible convergence - and thus greater similarity - and divergence - and thus greater diversity - of these frameworks. Relating to this is a concern about the extent to which diversities between countries tend to persist and the role played by public policy in reproducing this diversity (see e.g. Higgins 1981, Skocpol and Amenta 1986, Heidenheimer et al 1990 pp 6).

The classic approach to comparative political investigations is inspired by the analysis of industrialism by Kerr, Dunlop, Harbison, and Myers (1960). The essence of their argument is that nations respond to the general process of industrialisation, economic growth, and social modernisation with basically similar policies. Kerr et al argue that all nations are caught up in a universal and evolutionist “logic of industrialisation” which produces increasing convergence in social structures as nations world-wide move from the traditional agrarian to the modern industrial type of society. Rising levels of economic development and industrialisation are seen as creating new social problems as well as providing greater financial resources that governments can utilise in reacting to these problems. According to this convergence hypothesis, discrepancies in social frameworks will tend to disappear as the development in social organisation and social policies increasingly becomes a function of the development of industrial society at large and economic growth in particular.

A recent study within this school of thought is Gordon’s (1988) comparative analysis of social security policy in industrial countries. She analyses 25 countries including, for instance, Poland, Greece, Germany, Japan, and Canada, and she includes in her investigation the whole area of social security - for instance health, training, education, and income maintenance. Her aim is not so much to carry out a systematic comparison of the countries and the various policy schemes but, instead, she attempts to detect global trends in the evolution of social security. Her central finding is that there has been a general world-wide trend towards more integrated systems after World War II. But with the slow down in economic growth and the simultaneous increase in social security expenditure - caused by an ageing population and the increase in unemployment - social security has come under
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attack which may eventually lead to reduced emphasis on both universal benefits and social insurance programmes.

In the last decade the universal “logic of industrialisation” perspective has been increasingly criticised for being deterministic and for overlooking important divergences between countries. Whilst the broad-scale mapping of social security systems in the industrial world can be informative, the approach tends to lead to rather encyclopaedic-type surveys which do not involve any close examination of the specific features of the many policy programmes and of the many countries in the various samples. On a more fundamental note, empirical research suggests that there is not necessarily a correlation between the wealth of a nation and its commitment towards social security, and different nations, with the same level of industrialisation and similar patterns of economic growth, pursue diverse strategies in dealing with social problems (Flora and Heidenheimer (eds) 1981). There is also evidence suggesting that whilst there is a trend towards greater convergence in some policy areas, there are also trends towards greater diversities in other areas (Heidenheimer et al 1990). Such findings reject the idea of a universal “modern” type of social organisation and social policy framework towards which all industrial societies are evolving.

An important attempt to develop a more fruitful approach towards both the global and the microscopic perspectives is Berger, Piore, and Sabel’s theory of industrial society and social organisation (Berger and Piore 1980, Sabel 1982, Piore and Sabel 1984). They argue that the basic features of the division of labour and the segmentation of the work force have been fundamentally similar in industrial societies through most of their histories. There has been a common trend in industrial organisation evolving from Taylorism and Fordism of the 1930s to the flexible specialisation of today. But this common trend has gone hand in hand with the preservation and the fortification of diversities in national frameworks. The argument is that competition and diffusion from leading nations put pressure on less advanced countries as these countries must at least meet the efficiency standards of their powerful competitors if they are to preserve their independence. But countries which adopt the new techniques and modes of organisation from abroad do so for a
double and apparently self-contradictory motive: to become like their most advanced rivals, but to remain just as they are (Sabel 1982 p 27). By imitating the most powerful competitors and by adjusting to the most successful techniques of the day, countries can defend and preserve their individuality and their basic institutional framework.

The prime short-coming of both theories of industrialisation and theories of flexible specialisation is the lack of a positive theory of the state and state action. Piore and his colleagues’ alternative theory of industrial society contains no explicit theory of the role of government intervention but rather an interesting set of hypotheses describing the persistence of diversity among countries and the reaction and adjustment of existing institutions to external change. However political scientists have spent much effort recently in developing a more adequate understanding of the state as an independent socio-economic actor. The essence of the political research is to understand the state in relation to social structures and important issues are state autonomy and state capacities as well as various aspects of the formation and the reorganisation of states (Evans et al 1985). A promising research strategy that has developed from these concepts examines the autonomy of the state and the capacity for state intervention by tracing the political consequences of already instituted policies. By this is meant that once policies are enacted and implemented, they change the public agenda and they affect the processes through which subsequent policy changes occur (Skocpol and Amenta 1986 pp 149).

The new political concepts of state intervention suggest that one of the most important factors in determining present policy choices is past choices and their manifestation in the existing political and institutional framework, a point which is supported by empirical research. For instance Alber, in a study of the evolution of unemployment insurance in Western Europe, finds that “the present schemes largely reflect the initial regulations” and his “study of legislative provisions reveals [that] the original regulations of introductory laws tend to persist” (Alber 1981 pp 177-178). Following this, existing political-institutional frameworks shape and define the agenda for considerations of reform as well as the state’s capacities for political action. This implies that there is no universal logic - be it industrialism or
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market forces - overruling the basic institutional framework of society and the state. Instead, diversities among industrial societies are maintained and state institutions play an important role in reproducing these diversities. Certain events - such as the breakthrough of capitalism, the second world war, the end of Stalinism, and European integration - may however be sufficiently disruptive to question the basic socio-economic and institutional framework. In such circumstances a reorganisation of state policies may be forced upon the institutional framework but once a new framework and a new set of rules are in place they tend to persist for long periods of time.

2.3 On the economic approach to policy analyses

Whilst political scientists have tended to see state interventionism as a response to the demands of industrialisation, modernisation, and flexible specialisation, economists have tended to see state interventionism as a rational response to imperfections in the market economy and in particular the failure of markets to meet socially expressed needs. Hence in his classic article on the welfare economics of medical care, Arrow finds that “when the market fails to achieve an optimal state, society will, to some extent at least, recognise the gap, and nonmarket social institutions will arise attempting to bridge it” (Arrow 1963 p 947). Related to this positive explanation, a normative justification is provided stating that society ought to intervene so that an optimal state is created and secured. The condition for intervention is specified in social welfare and social choice theory as a question of choice under constraints: “Any kind of decision, social or individual, can be regarded as the interaction of the preferences or desires of the decision maker with the range of alternative decisions actually available to him, to be termed the opportunity set. The latter may vary from time to time because of changes in the wealth or technology of the community” (Arrow 1973, cited from 1984 p 115).

In a broader sense, welfare economics consists of three elements. Firstly, the formulation of the conditions which must be met if the joint welfare of the individuals in a group is to be at an optimum. Secondly, the study of how these conditions can be realised by the institutions of this group and by means of policies
which will be carried out within the framework of these institutions. Thirdly, the critical assessment of the contribution of existing group institutions and the existing group policy to joint welfare (see Van den Doel and Van Velthoven 1993 p 8).

Individual choice is described analytically in general equilibrium theory, but there are formidable conceptual and analytical problems in analysing collective choice and decision making. Theory has aimed at constructing universal social choice criteria which comply with welfare maximisation, an aim which contrasts sharply with practical empirical applications which have investigated almost exclusively single countries. “Economists have not traditionally made great use of the comparative approach, certainly less so than other social scientists” (Atkinson 1993 pp 2-3). To the extent that there has been feedback from empirical to theoretical research, it has thus been drawn from localised, single country experiences. But as demonstrated by political science research, policy schemes vary considerably among countries and these diversities tend to persist. The insights to be gained from the study of only one case are therefore limited. When looking at issues - such as state interventionism - of which there exists only one case in a given country, it is natural to increase the sample size by including more than one country in the investigation. Industrial economics has not been developed on the basis of observations of just one firm (e.g. IBM or Jack’s Van Hire) and public economics also needs to observe in a systematic fashion a wide number of cases.

In methodological terms, multi-country studies amount to an increase in sample size. Instead of looking at just one type of voting system or one design of policy a multitude of examples are investigated. Cross-country research in effect looks at a wider set of preferences and a larger opportunity set than does single-country research. This should allow us to investigate not only universal similarities in policy choice but also significant differences.

Our starting point is to consider the welfare economic model of markets and government action, as summarised briefly above, although this model has been criticised by the public choice school of thought for lacking a positive theory of government interventionism. We shall return to this issue later in the paper. Here it suffices to say that the differences between the traditional social-optimality
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approach and the public choice approach should not be overstated, since both are useful in their respective roles (Cullis and Jones 1992 p 24). In much the same manner as with the new hypotheses in political science, the role of public choice theory has been to put the state at centre stage, and to view the state as an institution and a socio-economic actor, thereby helping to overcome simplified functionalist views of government intervention. Economists have thus responded to the challenge laid down by Atkinson and Stiglitz: “[The] very real features of government behaviour - and the wider political structure - must be taken into account in any realistic assessment of the prospects for reform. In this return to “political economy”, a great deal remains to be done” (Atkinson and Stiglitz 1980 p 576, as the conclusion to Lectures in Public Economics).

Following the criticisms raised by public choice theorists, it is now clear that orthodox welfare economic policy analysis should not be perceived as a positive theory of state action, but rather more modestly as a useful theoretical framework for assessing policy and the outcome of state intervention (Sandmo 1990). However, “the application of public choice ideas to concrete policy situations is still relatively new” (Wiseman 1991 p 67) and applied orthodoxy continues to provide the benchmark for developments of new ideas.

This applies even more because new developments and refinements of the welfare economic model have meant that “the welfare analysis of efficiency, market failure, and the design of public policies to improve efficiency has strengthened its foothold after the public choice criticism” (Sandmo 1990 p 59). The strengthening of welfare economic analysis, alluded to by Sandmo, is the result of recent work which aim at providing an improved understanding of the functioning of markets. This work has major implications for the concepts of the efficiency and the equity of the market system and thereby also for providing a rationale for state intervention. The conventional view, as framed by Musgrave (1959), separates micro-economic policy intervention into allocation and distribution branches with welfare state policies being concerned mainly with distributional issues (see also Musgrave and Musgrave 1989). By contrast, on the basis of an application of the new welfare economic notions of market failures to analyses of the welfare state
Barr argues, in the tradition of Arrow, that the welfare state should be viewed as an “efficiency device” (Barr 1987, 1989, 1992). Barr’s argument is based on recent refinements of general equilibrium theory, which we shall turn to now.

2.4 Market failures and the welfare state

General equilibrium theory shows the extent to which a social allocation of resources can be achieved by independent private decisions co-ordinated through the market (see for instance Arrow 1985a, 1985b, Hahn 1982a, Hammond 1985, 1990). Under certain conditions decentralised individualised decision making and choice does not lead to anarchy but to an economically coherent disposition of resources where aggregate supply equals aggregate demand. Agents pursue their own interests and market clearing prices serve as communications links about the needs and production possibilities of the individual agents. The two fundamental theorems of welfare economics state that under certain conditions competitive markets have the property of achieving a Pareto efficient allocation of resources and that the market mechanism is distributionally neutral. Agents keep on trading until no-one can be made better off from further trade and a Pareto efficient allocation describes a situation where no reallocation can make any agent better off without making at least one other agent worse off. The notion that the market mechanism is distributionally neutral means that there exist many Pareto efficient allocations, each of which will have a different distribution of welfare. Thus in the ideal world of the model, any distribution of wealth (endowments) is attainable in the sense that it generates Pareto efficient outcomes.

When considering the usefulness of the welfare economic approach for policy analysis, it is important to bear in mind the methodological and empirical status of the theory. The theory is rather a logical coherent way of thinking about the market economy than a description of this economy. This situation was pointed out already in 1972 by Hahn who found that the “lack of contact between the economic theory and the sociological reality may well be the most damaging criticism of the neo-classical construction” (Hahn 1972 p 2). The difference between “theory” and “reality” means that the descriptive power of the model applies only within the
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 logarithical and descriptive limitations that are set by the standard assumptions and encapsulated in the phrase “under certain conditions” (Hahn 1982a). When these conditions are not met, the market is said to fail by which is meant “the failure of a more or less idealised system of price-market institutions to sustain “desirable” or to stop “undesirable” activities. The desirability of an activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem” (Bator 1958 p 351).

There are a number of circumstances under which the real world market mechanism fails to satisfy the efficiency conditions of the competitive model (Atkinson and Stiglitz 1980 pp 347, Stiglitz 1988 pp 71). Traditional analyses and classifications of market failures include firstly the failure of the market structure. Self-policing competition requires a large number of producers and consumers in every market. However, increasing returns to scale may lead to the development of monopolies or imperfect competition, and thereby make the perfectly competitive hypothesis invalid. A second reason for market failures are external economies. Externalities arise when the production or consumption of a good affects producers or consumers not involved in buying or selling it. Thus, production and consumption may lead to external costs and benefits that are not easily tradeable in a market. Thirdly, a special class of externalities arises from social or public goods. A public good is characterised by non-rivalry in consumption so that one person’s consumption does not reduce the amount available to others and by non-excludability, so that no-one can be excluded from consuming the good. Because agents can not be excluded from consumption, free rider problems arise with no-one willing to pay voluntarily for the good in question.

Barr (1992) argues that these “traditional” forms of market failure render little support for social security and the welfare state. In fact, “to the extent that the traditional market failures support welfare-state institutions at all, they justify only a residual welfare state” (Barr 1992 p 749). However, in the past twenty years or so further efforts have been made in refining the welfare economic model. This research has been concerned with exploring the implications of relaxing the assumption in the traditional model of perfect information in the face of uncertainty.
Integrating the concept of imperfect information into the competitive model has serious consequences for the understanding of the market mechanism: “Indeed, all the fundamental results of competitive analysis - the existence theorem, the optimality theorem, and the characterisation results (e.g. the Law of the Single Price) are invalid if information is imperfect and costly to acquire” (Atkinson and Stiglitz 1980 p 349). In this situation the market system may be incomplete. Markets may be missing and the system may fail to provide a good or service because the costs of running the market are too high or because asymmetric information gives rise to adverse selection, moral hazard, or principal-agent problems (Newbery 1989 p 218).

A “classic” example of a market that is incomplete is the risk and insurance market (Arrow 1963, 1974, 1986). The market economy has not been able to develop comprehensive insurance against certain risks - for instance unemployment. But the absence of markets leads to market as well as non-market responses. Thus the response of the market economy to the lack of comprehensive private unemployment insurance might be long-term labour contracts (absorbing some of the risks of redundancy) and private savings, whilst the response of the state might be public unemployment insurance.

The recent refinements of the general equilibrium model have direct implications for policy analyses in that the issues of efficiency and distribution are intertwined to a much larger extent than was assumed in the traditional policy model: “It is noteworthy that virtually nowhere is there a system of subsidies that has as its aim simply an equalisation of income.... Thus optimality, in a context which includes risk-bearing, includes much that appears to be motivated by distributional value judgements when looked at in a narrower context” (Arrow 1963 pp 947-948). Any practical policy aiming at improving efficiency would inevitably favour some individuals but any redistributive policy would also affect efficiency. The separation of efficiency and distribution is therefore useful only as a general classification of possible policy aims, and can not be used to classify individual policy schemes. Hence while welfare state policies in the tradition of Musgrave were thought of as being concerned exclusively with the issue of redistribution, they
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are now thought of as dealing with efficiency also: “The welfare state is much more than a safety net; it is justified not simply by any redistributive aims one may (or may not) have, but because it does things which private markets for technical reasons either would not do at all, or would do inefficiently. We need a welfare state of some sort for efficiency reasons, and would continue to do so even if all distributional problems have been solved” (Barr 1987 p 421).

2.5 Features of state action

Arrow’s seminal work left open the issue of what type of organisation would fill the gap when markets fail to achieve optimality. The theme of his contributions was the choice of market versus nonmarket allocations (Arrow 1970) and his analysis of the welfare economics of medical care began with a diligent survey of the special characteristics of the American medical care industry with its multitude of institutions (Arrow 1963 pp 948). In the last decade the focus of attention in welfare economics has been narrowed down to a concern about state action, with an interesting exception being Sugden’s (1984) analysis of voluntary organisations.

Two contributions by Stiglitz (1988, 1989) provide a synthesis of recent welfare economic work on this issue. Stiglitz argues that there are two distinguishing features of the state, from which most of the other differences between the state and other economic organisations follow: “the state is the one organisation membership of which is universal, and the state has powers of compulsion not given to other economic organisations” (Stiglitz 1989 p 21). In contrast to the state all private sector organisations, irrespective of their size, are essentially voluntary. Stiglitz argues that the appropriateness of state action should be judged by considering whether compulsion and universality are advantageous for solving economic problems.

The notion of universalism is based on the observation that people do not view the country in which they live to be a matter of choice and immigrants, having chosen to live in a particular country, become subject to the state. In contrast, individuals choose to be members of clubs, they choose to buy stock in a corporation, they choose to work for one firm or another, and they can choose to
live in one community or another. By the same token, Stiglitz argues that the state has a power of compulsion which other organisations do not have. All transactions between parties other than the state are voluntary. From this some strong inferences can be made, for instance, that the transaction must have made both parties better off. In contrast, transactions with the state are not necessarily voluntary, and some individuals may be made worse off as a result of these types of transactions. The most important example of governments’ power of compulsion is the power to tax. Individuals do not make an individual decision about how much to contribute to the state, and they do not assess the value of the services provided to them by the government and pay a commensurate amount.

The powers of compulsion and universal membership mean that the governance structure of the state is far more important than in private sector firms according to Stiglitz. He argues that there are two important constraints caused by government revenues being raised compulsorily. First, because individual performance in the public sector is hard to measure, arbitrary (non-performance related) salary constraints are imposed. Without constraints, the government could use public funds for private interests by paying excessive salaries to its employees. Secondly, because of the universal and compulsory nature of the state, public programmes must be administered in an equitable way. If policy does not appear to be fair and equitable it may come into conflict with democratic principles. The equity constraint often makes it difficult to adjust treatments of different people to their different circumstances.

Stiglitz’s hypotheses do not pretend to add up to a new grand theory of state action. He proposes instead a pragmatic or eclectic view of the state, which provides a framework for analysing the advantages and disadvantages of micro-economic intervention given the experiences with mixed economies over the last century. His basic view is that market failures are sufficiently large to warrant systematic intervention into the market economy. Indeed, he finds that it is only under exceptional circumstances that markets are efficient, and “efficient market allocations cannot be attained without government intervention” (Stiglitz 1989 p 37). Conflicts of interest associated with market failures render voluntary solutions
impossible or unsatisfactory. To alleviate market failures and enhance efficiency it is necessary to apply the compulsory power of the state. Moreover, to the extent that redistribution is involved, compulsion is required because individuals are not generally prepared to voluntarily surrender some of what they have to someone else. Without government intervention there would be little (and only charitable) redistribution in the economy.

However, some of the same factors giving rise to market failures may also lead to government failures and the full costs of some types of intervention may be higher than the benefits to be gained from rectifying cases of market failure. In addition, just as the nature of markets can give rise to market failures, the nature of government can give rise to government failures. Stiglitz (1988 pp 5) suggests four major reasons for the systematic failure of governments to achieve their stated objectives. Firstly, governments have limited information, and the consequences of many actions are complicated and difficult to foresee. Secondly, governments have only limited control over private market responses to and consequences of their actions. Thirdly, governments have limited control over bureaucracy. Fourthly, there are limitations imposed by political processes such that governments have to find ways of reconciling or making choices among conflicting preferences. Stiglitz argues that it is important to be aware of these limitations and constraints on government intervention when exploring particular policies and policy options. The institutional design features of policy schemes should be included in the investigation, and it is important to consider all effects of policy schemes, including unintended side-effects.

2.6 The economics of “second best”

Welfare economic theory is still being developed and many of the new models have not yet been made operational empirically. However, the improved realism of the theory has to some extent made its empirical application to policy analysis more demanding. The simple concept of a trade-off between efficiency and equity, according to which welfare state policies are perceived as enhancing equity which in turn is paid for by a decline in efficiency is delusive. Instead we are faced with a
far more complex problem of policy evaluation, in which every scheme needs to be examined both from the point of view of efficiency and equity. We now provide two examples of the theoretical and empirical issues involved, and examine aspects of the analytical complications which follow from viewing the welfare state as an efficiency device and which need to be resolved.

(a) *Incentive constraints*

One implication of the new notion of the welfare state is that only “second best” policies and contracts are possible. In effect, welfare comparisons have to be made between second best or even missing private arrangements and second best public policies. According to Atkinson and Stiglitz, “the second-best problems can be viewed as problems of indirect control” (Atkinson and Stiglitz 1980 p 358). A government might like to control directly individual behaviour (e.g. consumption, labour supply), but it cannot. It must therefore resort to instruments which affect and control behaviour indirectly. The problem with these indirect measures is that they may have distortionary effects on individual behaviour and incentives. Lack of direct control is also a problem in private arrangements, and may lead to situations where private contracts cannot be concluded.

First best contracts are possible when all agents follow the rules and are capable of handling the informational requirements. However, in many situations the question arises whether mechanisms exist which are also informationally feasible and compatible with the incentives of participants: “Two agents cannot enter into a contract in which delivery is contingent on an event which they cannot observe. For certainly, our greedy agents do not trust each other. Hence, if information differs between agents, certain contingent markets cannot exist as a matter of logic” (Hahn 1982a p 6). Alternatively, contracts may be feasible but when information is asymmetric or not verifiable and agents have an incentive to cheat, efficient risk-bearing may have to be sacrificed in order to provide incentives for the appropriate choice of action (Coles and Malcomson 1989). In this sense private market arrangements are constrained by incentives.
Hammond, reviewing the findings of the literature, raises the issue of “incentive constraints” more generally, by arguing that there are two different Pareto frontiers. One, corresponding to fully Pareto-efficient allocations, ignores incentive constraints. The second does recognize these constraints and so lies within the first (Hammond 1985 p 420). On this view, incentive problems are the result less of public provision than of imperfect information. In fact, “incentives provide a rationale for many forms of government intervention in order to move the economy around the incentive-constrained Pareto frontier” (Hammond op cit. p 421).

Following similar lines, Arnott and Stiglitz argue that one of the advantages the government has over private organisations in dealing with moral hazard and incentive problems is universality, “along with which come advantages of scale and scope in reaching, monitoring, and enforcing agreements” and they provide the example that “it is considerably cheaper to have the police monitor reckless driving than it would be for each insurance company to monitor its own clients’ driving” (Arnott and Stiglitz 1991 p 117).

Welfare state policies provide ample examples of circumstances in which the government is at an advantage over private organisations in dealing with moral hazard and incentives; here we only consider unemployment insurance. Private unemployment insurance provides a useful example of a situation where private organisations have not been able to develop universal measures for the policing and control of moral hazard. Hence Barr argues that “the possibility of moral hazard (to a large extent irrespective of whether or not it actually occurs) makes unemployment a risk which the private insurance market will not cover” (Barr 1988 p 11). Only limited insurance for professionals might be possible. He supports his view in an analysis of mortgage protection policies covering unemployment, supplied by building societies and banks in the UK. Barr argues that these private policies exist only because they are limited to owner-occupiers, who tend to be in secure jobs facing a low probability of becoming unemployed. They also side-step the worst problems of moral hazard because “owner-occupiers are among the more highly paid and so face lower national insurance replacement rates” (Barr op cit p 15).
A further characteristic of these policies, not mentioned by Barr, is that they typically require that insureds sign on at the labour exchanges in the event of unemployment, thereby leaving an important aspect of control against moral hazard to a public body. This situation might suggest that, as in Arnott and Stiglitz’s example of the policing of roads, the policing of the unemployed is carried out most efficiently by a public body. The government is in a better position to exercise direct and universal control than are private bodies because of the severe information and incentive problems characterising private arrangements. A public sector body monitoring the unemployed appears to be helpful and advantageous for the functioning of private unemployment insurance.

It needs to be stressed, however, that this conclusion provides only a first step in a welfare economic evaluation procedure. Following Arnott and Stiglitz (1991 pp 116), potential market failures caused by moral hazard become actual market failures only when the benefits of government intervention exceed the costs. Benefits are to be estimated in terms of the deadweight losses associated with the inefficiencies of private arrangements and costs have to capture the inefficiencies caused by government intervention. Performing this kind of benefit-cost analysis and thereby documenting that the before-mentioned public institutions are indeed efficient is obviously a complex task which requires distributional judgements. For instance, it could be argued that the provision of free policing of drivers implies that the cost of insurance is lower than it would otherwise be, and that this encourages more drivers on to the roads, thereby (potentially) increasing the amount of reckless driving. Groups of tax-payers (e.g. those who do not use roads) may also feel that spending money on policing traffic is wasteful in comparison to spending more money on residential care or any other type of state spending from which they stand to benefit. Similarly, the free policing of the unemployed in Britain provides an indirect subsidy to the premiums of mortgage protection insurance thereby benefiting owner-occupiers who, according to Barr, are better-off people. Finally, the more specific trade-offs between efficient risk-bearing and direct and indirect measures of control need to be brought out. It is a complex empirical issue to
determine the optimal amount of control, including the optimal number of policemen and labour exchanges (and officials).

(b) Labour market segmentation

A second implication of recent refinements of the economic theory of policy design concerns analysis of the interplay between welfare state policies and distortions in related markets. The importance of accounting for the interplay between distortions in interrelated markets was the subject matter of the classic formulation of second best by Lipsey and Lancaster (1956). It follows from the general theory of second best that “in a situation in which there exist many constraints which prevent the fulfilment of the Pareto optimum conditions, the removal of any one constraint may affect welfare or efficiency either by raising it, by lowering it, or by leaving it unchanged” (Lipsey and Lancaster op cit. p 12). Yet much micro-economic policy analysis continues to consider “conformity with the standard assumptions in a given area whilst implicitly assuming they hold in all other areas” (Barr 1987 p 99).

This fallacy applies also to a considerable amount of the literature on the adverse incentive effects of unemployment insurance which in effect assumes that public insurance leads to distortions in an otherwise perfectly competitive labour market, ignoring the fact that this market is segmented. If the labour market complies with the notions of the competitive model, it is clear \textit{a priori} that any unemployment insurance scheme would be distortionary. However, under the more realistic assumption that the labour market is segmented, \textit{a priori} there is no way to judge the efficiency effects of unemployment insurance on the labour market.

Recent work by Atkinson and Micklewright aims to clarify the issue by investigating the impact of unemployment insurance in a dual labour market (Atkinson 1990a, 1991a, Micklewright 1991, Atkinson and Micklewright 1991 pp 1704). The Atkinson and Micklewright model assumes a simple dual labour market consisting of primary and secondary sector jobs. Entitlement to unemployment insurance benefits is restricted to primary sector jobs because contribution conditions exclude from unemployment insurance those outside the industrial sector and those in contract jobs. Contributions impose a cost on the primary sector. On
the other hand, the prospect of unemployment insurance in the event of future unemployment improves the total reward offered by the primary sector, and reduces the equilibrium level of the primary sector wage. Shirking carries a risk not only of dismissal but also of disqualification from benefits because provisions in insurance schemes refuse benefits if a person has entered unemployment voluntarily or as a result of misconduct.

Given these considerations, the model suggests there is a positive as well as a negative dimension to unemployment insurance as far as employers, and employment, is concerned: “The total effect of a UI scheme is made up of an unfavourable effect on employment arising from the contributions side and a favourable effect arising from the benefit side. This means that, if a government reduces benefits while leaving contributions unchanged, we would expect this to have an adverse effect on employment” (Atkinson 1990a p 31). Atkinson applies the model to current UK policy and finds that recent reductions in benefit generosity with no off-setting reduction in contributions may be expected to have made primary sector employment less attractive, putting upward pressure on wages in that sector thereby increasing unemployment. Moreover, “there is a shift towards secondary sector employment; in effect a transfer from “good jobs” to “bad jobs”” (Atkinson 1990a p 31). Micklewright looks at the Italian example and finds that because unemployment insurance improves the total reward offered by the primary sector, “the introduction of a proper UI scheme in Italy, ...., could be seen as a way of influencing the choice between the legal and the underground economies” (Micklewright 1991 p 422).

The Atkinson-Micklewright model raises complex issues concerning the comparative efficiency of unemployment insurance and labour markets in countries such as Denmark and Germany. Denmark has one of the world's most generous benefit systems, in terms of a short qualifying period, high benefit levels, and long benefit duration. However, it also enjoys lax rules concerning hiring and firing of workers and, in fact, “Denmark’s legislation on dismissals is the most liberal in the EC” (Emerson 1988a p 782). Contributions cover only a part of outlay to insurance. The German regime contrasts sharply to the Danish. The strongly earnings-related
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benefit schedule means that primary sector workers in Germany enjoy high levels of insurance benefits. On the other hand, to reach high levels - be it pensions or unemployment insurance - workers need to have long contribution records. In the case of unemployment insurance (but not pensions), duration of benefit receipt is fairly limited. Contributions cover the full costs of insurance. The benefit regime is complemented by a system of labour market regulation which imposes severe restrictions on the hiring and firing of workers (Emerson op cit.).

Evaluating these contrasting regimes on the basis of the Atkinson-Micklewright model is intriguing, and provides an example of how conclusions derived from a first best view may be invalid when second best features are taken into account. From a simplistic point of view, the Danish regime might be characterised as both more efficient and equitable than the German. A high proportion of the unemployed in Denmark gain access to insurance benefits (equity) and the labour market appears to function in accordance with the standard assumptions of the competitive model. Yet the issue of equity becomes more complex when account is taken of the fact that easy access implies that relatively generous benefits are given to young single people and both earners in dual earner families. The German system tends to benefit the main earner in dual earner families who work in the primary sector. Similar difficulties arise with regard to efficiency. It is a condition of the Atkinson model that “only a proportion of the unemployed (the “insured unemployed”) receive benefits” (1990a p 30).

Similar considerations in Micklewright (1991) relating to the “entitlement effect” of unemployment insurance suggest that when contribution conditions become very short, the beneficial effects of a UI system in creating good primary sector jobs disappears. This would suggests that the Danish labour market and unemployment insurance regime might be less efficient than the German, even though it complies more closely to the competitive model of labour markets. It is an issue for further research to develop the Atkinson-Micklewright model further so as to capture more of the diverse links between insurance and the labour market which can be observed in industrial countries.
Such research also needs to take into account that labour markets are segmented not only along industrial lines but also along occupational lines. Unemployment insurance may have different effects in occupational labour markets than in industrial ones. A further point to consider is that adequate insurance may help in modifying trends towards labour market segmentation thereby making labour markets more flexible. As stressed by Arrow, “the possibility of shifting risks, of insurance in the broadest sense, permits individuals to engage in risky activities which they would not otherwise undertake” (Arrow 1974 p 137). An efficient insurance scheme eases peoples’ anxieties about losing their jobs and not being able to find a new one. It may therefore help improve both horizontal and vertical mobility because people may be less reluctant to try out different options when they have sufficient protection against possible failure. Furthermore, in heavily unionised economies inadequate insurance schemes may be counterbalanced by the imposition of restrictive job protection arrangements. Trade unions may respond to the threat of unemployment by restricting flexibility in the labour market and by demanding both barriers against recruitment and barriers against dismissals of employees.

2.7 Preferences and government policy

We have considered welfare economic concepts of efficiency and equity, and some of the implications of these concepts for policy design. However, “the distinction between equity and efficiency is in a sense artificial since both are subsumed in the objective of maximising social welfare” (Atkinson and Stiglitz 1980 p 360). For welfare state analysis this implies that it would be misleading to base an economic analysis of social insurance solely on an analysis of market failure in insurance markets. “This applies to both the explanation and the justification of social insurance” (Atkinson 1991a p 115). The fact that private markets are unable to provide adequate insurance does not mean that insurance is needed with respect to welfare maximisation. One way of exploring this issue is to look at the evolution of the economy and to consider why social insurance was needed. Atkinson argues that “the role of social
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insurance is only comprehensible in the light of the development of the modern labour market” (op cit. p 114). In pursuing this point, he concentrates on the British example and stresses that this “is a major qualification, since the development of National Insurance in Britain has undoubtedly reflected its political, social and economic circumstances, and these differ from country to country” (op cit. p 114).

For comparative analyses there is the added problem that pinpointing general reasons for market failure does not provide an explanation of the diverse forms taken by unemployment insurance in different countries. An improvement in social welfare by alleviating market failure can be carried out in different ways. According to Barr, his theory of the welfare state is universal in the sense that it can be applied to all developed economies and in large measure also to developing countries and he justifies this view with reference to the political theory of convergence (Barr 1992 p 758). But Barr thereby ignores the more recent findings relating to the persistence of diversities in policy frameworks between countries (see section 2 of this paper). In fact, the institutions which he claims are the logical result of failures in insurance markets bear a striking resemblance to the peculiar British institutions (see Barr op cit. pp 754). His analysis of policy responses to market failures does not include the possibility that these responses may vary considerably in different countries.

On the basis of orthodox welfare economics it may be possible to construct an explanation as to why some peculiar and seemingly irrational set of institutions might make sense as a set of optimal responses to a given environment, as in recent work by Treble and Vicary (1993) on the institutional design of insurance and wage payment structures in Victorian county Durham. However, the complexity of this approach increases exponentially when we have more than one set of institutions, each of which appear to be equally optimal. For instance, there is nothing a priori to suggest that the British social insurance system maximises welfare to a higher degree than the Scandinavian and German systems. Hence, welfare economic analyses of market failure do not suffice to explain the various shapes actually taken by social insurance schemes. Looking at the development of the modern labour market does not solve this problem because there is no direct link between this
development and the development of a particular social insurance scheme. Additional analytical concepts are therefore needed for policy analysis.

(a) Citizens’ wishes

One way of establishing a link between the need for social security and government policy is to consider individual preferences and procedural rules, and argue that these differ between countries. This approach, which relates to public choice theory, is followed by Wiseman (1991) who argues that the welfare state should not be identified with some particular bundle of policies. Welfare ought instead to be identified with the existence of caring feelings which in turn are expressed differently in different countries. From this he argues that “welfare efficiency” is to be appraised, not by reference to some universal abstract general standard, but by the consonance of welfare policies with the wishes of the citizens. There is no reason to believe that the diversity of welfare policies to be observed between countries is incompatible with “welfare efficiency” in this sense” (Wiseman op cit. p 55). He finds furthermore that “there is no one “right” system of delivery of any particular good or service waiting to be discovered, and there is nothing surprising or disturbing in the observation that different countries adopt different arrangements for such services as health care” (op cit. p 64).

We have considerable sympathy with the Wiseman argument. The fact that the framework of social security systems have changed very little since their creation does not mean that there are no alternatives. The existence of feasible alternatives are given by the fact that diverse systems exists. Rather it suggests that a degree of acceptance can be found within the societies concerned, and that there is a certain degree of consonance between the systems and the preferences and wishes of citizens in the different countries concerned. Surveys of social policy opinions in different countries support this in that they suggest that “across nations with different social policy systems, there is a high degree of popular acceptance of and support for such social policies as are in operation” (Ringen 1987 p 204). Furthermore, it appears reasonable to assume that if, for instance, the British population and electorate had developed a strong preference for a Danish or
German style welfare state (or any other system) they would have found ways of implementing such a system over the past century. However, this does not mean that it is impossible to compare the advantages and disadvantages of different systems, and draw policy implications from the findings. To suggest, as does Wiseman, that all policy schemes are equally “good” or “right” would not be a very powerful starting point for policy analysis.

The evaluation of the goodness of endstates is at the heart of the welfare economic approach; “all choices, including the selection of actions, practices, institutions, etc must be guided exclusively by the goodness of consequent states of affairs” (Sen 1994 p 3). The goodness of a state of affairs is determined by aggregating individual utilities in the respective states. Yet difficulties in empirically operationalising these notions means that more basic and pragmatic approaches are adopted. One prominent method of analysing government policy is to apply the revealed preference approach of standard welfare theory of consumer choice, and to look at the revealed preferences of “the government”.

(b) Revealed preferences

This approach is for example adopted by Atkinson (1991b) in an analysis of the objective of securing a national minimum of social security benefits in Britain. He describes the approach thus: “From the choices made about the level of benefits, it may be possible to make deductions about the objectives which lay behind them - a revealed preference argument - and it may be possible to learn from the expressed intentions of governments” (Atkinson 1991b p 121). A similar strategy is also followed by Creedy and Disney (1985) in an investigation of British social insurance. The aim of their investigation is to consider within a British context the extent to which trade-offs among policy objectives must be made. They stress that “a complete “optimisation model” which may for example specify the optimal choice, given a fully specified social welfare function in terms of individual utilities, has not been used. A more basic approach has been used which nevertheless allows a number of simple policies to be compared” (op cit. p 4). The more basic approach consists of using welfare economic concepts to rationalize the
existing British social security system and to examine some of its consequences. Following this approach, the basic institutional framework and policy choices are taken as given, and the objective is to detect inconsistencies within the framework and to clarify trade-offs between conflicting objectives.

On this view, what can be done with the tools of welfare economics is firstly to detect forms of market failure, and secondly to examine the rationale of existing schemes with a view to seeking alternatives which can be implemented without making fundamental changes to the basic framework. Analogous to the revealed preference approach in consumer theory, analyses of the revealed preferences of governments attempt to evaluate choices and policy in terms of the governments’ own systems of values, and the job of scientific analysis is to check for consistencies and possible inconsistencies in choice (Le Grand 1991 pp 53). The main limitation of the approach is that it effectively assumes that whatever the government chooses is the right choice. Atkinson does not question the rationale for a national minimum of social security benefits but focuses on identifying ambiguity in attitudes towards benefits in Britain and to indicate the dimensions along which clarification is necessary. Apart from brief consideration of alternative arrangements for provision of sickness benefits, Creedy and Disney’s analysis of social security does not contain any serious reference to countries other than Britain.

The revealed preference argument may be useful in detecting the normative underpinning of a given system. However, serious difficulties arise when attempts are made to derive more generalised “meta-normative” statements on the basis of the preferences and normative values of a particular government or a limited number of government officials. For example, Goodin, with reference to Beveridge, finds that “linking benefits to prior earnings has obvious and inevitable effects that run clearly counter to all the goals that we have attributed to welfare states” (Goodin 1990 p 533). Within the same line of thought, Disney proposes a set of abstract, ideal criteria for evaluating unemployment insurance schemes. He suggests that an ideal scheme is one “providing at least a subsistence minimum level of benefit” as well as “equity of treatment, that is, individuals with the same needs
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should be treated identically and, of course, ... differential needs should lead to
differential treatment” (Disney 1982 p 37). Suppose a supra-national body with
unlimited power were to follow these normative criteria and conduct policy
accordingly. It would then mean that most European social insurance schemes
should be abolished in favour of the peculiar British system.

The limitations of existing applications of the revealed preference approach does
not mean that it cannot be used in a wider context for comparisons of policy
schemes. In fact, given the present state of knowledge a pragmatic approach seems
to be the only one feasible when comparing policy frameworks in different
countries. Most cross-country comparisons contain some implicit ranking of
systems but theory gives little guidance for such rankings. From a welfare economic
point of view, the ultimate justification for cross-country research is to compare
objectives, designs, and constraints, as well as overall performances in terms of
outcomes of diverse policy frameworks with a view to identify the best and the
worst features in each case. The basic sources of market failure in different mixed
economies may be similar; even the United States has no private unemployment
compensation scheme. Also, the basic policy objectives may be similar: the main
objective of unemployment compensation is to compensate the unemployed and not
to provide health care - although an adequate compensation scheme may help in
preventing ill health among the unemployed. When focusing on these similarities
among countries “it is possible to look at the political systems of different countries
as a range of experiments for solving common problems” (O’Higgins et al 1990 p
161) and the comparative analysis constitutes an “alternative reference standard”
(Atkinson 1990b) to the standards of performance that exist within individual
countries.

However, more fundamental differences among countries emerge when we start
to include the institutional frameworks themselves in the analysis. For instance,
Danish governments have placed a higher value on voluntary provision of
unemployment insurance than have British and German governments. In Britain,
the provision of social insurance is subsumed under the aim of creating a national
minimum of social welfare, a feature which plays only a very limited role in the provision of social insurance in Germany and Denmark.

Comparisons of these fundamental aspects of policy frameworks using the tools of welfare economics have so far not been undertaken. Therefore, given the present state of knowledge we can do no more than take a pragmatic view and begin from the assumption that no one system stands out as the optimal one. Instead each policy scheme is characterised by a unique institutional and regulatory framework which offers different advantages and disadvantages to the various groups affected by it. By investigating both similarities and differences between countries, and by looking at different empirical circumstances and “realities”, cross-country research can help in refining notions of choice and policy design.

2.8 The framework on choice

Welfare economic comparisons may help to make sense out of differences in policy schemes, but they do not explain them. To do so a notion of how preferences as well as differences in preferences come about is required. Wiseman, in the contribution discussed above, specifies the type of preferences which are important for welfare state analyses as “caring feelings” and finds that “the form and extent of such caring feelings is not given, any more than is the taste for apples” (Wiseman 1991 p 55). From the point of view of consumer theory, it may not be important to know why one person prefers apples and another prefers bananas. But it is of obvious interest to know for example why the citizens and governments of one country prefer flat-rated benefit systems and the citizens and governments of another country prefer earnings-related benefit systems.

A theory of preferences which implies that these are essentially stable across time and cultures is provided by Becker (1976). Stable preferences, according to Becker, do not refer to market goods and services like oranges and medical care but to “underlying objects of choice that are produced by each household using market goods and services, their own time, and other inputs. These underlying preferences are defined over fundamental aspects of life, such as health, prestige, sensual pleasure, benevolence, or envy, that do not always bear a stable relation to market
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goods and services” (Becker 1976 p 5). That a group of underlying preferences exists, perhaps defined in terms different from those used by Becker, is undoubtedly true. However, it is open to question how much the stable preference hypothesis actually explains. According to Hahn, it “seems clear that social and economic conditions can affect preferences. It is true that we know rather little about the process in practice..... There seems no compelling reason to suppose that there is a “real” and ultimate preference system over a large enough domain which is immutable under economic (and social) change” (Hahn 1982b p 190-191). Issues such as the forms and objectives of social security systems reach well beyond what can be understood in terms of fundamental underlying human preferences.

Yet, when preferences are endogenous to economic and social conditions and are, at least to an extent, products of a system rather than determinants of the system serious difficulties arise for both normative and positive analyses of welfare state arrangements. It then appears to be impossible to find a universal justification on the basis of human preferences for social security arrangements and, especially, for any particular way of arranging social security. A normative theory of social security may have to be argued with reference to a set of cultural and ethical values which may not necessarily be easy to detect when focusing on individual preferences.

For both normative and positive analysis, it makes a vast difference what kind of society is investigated and which countries are compared. Cultural and ethical values are likely to differ substantially between countries such as Mongolia and Iceland. But preference sets among Western societies are presumably much more alike, so an assumption that there is at least a basic similarity in “underlying” preferences appears to be appropriate when investigating these societies. The variations in preferences which can be observed are most likely to be attributable to variations in economic and social developments and the fact that the British population prefers Beveridge to Bismarck while the German population has a different set of preferences may be simply due to the fact that Beveridge’s principles are instituted in Britain, and Bismarck’s principles are instituted in Germany.
Flora and Alber (1981) argue that nineteenth century welfare systems in Europe were virtually identical, if not in detail then at least in terms of their basic principles, since they were based on a combination of local public and voluntary private arrangements. In depth historical research tends to support this view; at least with regard to the northern part of Europe (see e.g. Sweden: Edebalk 1975; Germany: Frerich and Frey 1993; Denmark: Møller 1981; Britain: Thane 1990). Differences in preferences and welfare systems between these countries therefore appear to be a twentieth century phenomenon. Whilst the general evolution of social insurance can be related to the development of the modern labour market (Piore 1987, Atkinson 1991a), differences between welfare systems appear to be related to the evolution of “modern” systems of government. Hence, a constitutional perspective on choice is worth examining.

This perspective has been acknowledged by political scientists such as Weale, who finds that “the stage of “constitutional choice” in the design of welfare systems is likely to be crucial. Once the framework on choice has been established, ... it will be difficult for ordinary political decisions to change” (Weale 1990 p 482). Received economic theories of the welfare state have tended to ignore these issues because they have been located in the tradition of the benevolent-dictator model, which states that central government has the insight, the will, and the power to implement policies so as to maximize social welfare. As we have seen, the benefit-cost calculus which follows from this approach is useful for examinations of existing policy arrangements but it provides only a limited basis for examining why diverse arrangements exist and how they come about.

Constitutional issues are considered in public and social choice theories. Broadly speaking, these theories focus on how political and economic institutions constrain, direct, and reflect individual behaviour. It is asserted that “the outcomes of a democratic process vary with the types of issues decided, the methods of representation, and the voting rules employed” (Mueller 1989 p 6). Although social and public choice theories do not claim to provide an explanation of how a given “framework on choice” is established and how diverse forms of social security arrangements come about, they provide a general perspective for analysis of these
issues. We now consider social choice theory and next we consider public choice theory.

(a) Constitutional and social choice

Arrow’s social choice theory can be seen as the first systematic attempt to address constitutional issues in economics. His contribution, which was first formulated in 1951, pioneered a new field of enquiry and although a vast literature has developed relating to the specific assumptions and methodology that were employed by Arrow, his contribution still defines the field of social choice theory (see Arrow 1973, 1977 (both reprinted in 1984), 1985b, 1987 as well as the recent surveys by Sen 1987, Inman 1987 pp 682, Mueller 1989 chapter 20). Arrow’s study arose as an attempt to give operational content to traditional concepts of social welfare functions. It is concerned with the relation between individual and society and it is assumed that each individual has some way of ranking social actions according to his preferences for the consequences. An individual judges alternative social actions according to his own standards and preference scales. However, “the individual preference orderings reflect their view of their social state and are not simply preferences over, say, their own consumption bundles. They are thus the individuals’ ethical preferences” (Gravelle and Rees 1992 p 502).

A constitution is defined as a social choice mechanism or decision process which leads to the formation of welfare judgements. “Specifically, a constitution is a rule that associates to each possible set of individual orderings a social choice function, that is, a rule for selecting a preferred action out of every possible environment” (Arrow 1985b p 142). The constitution must be designed so as to reflect individual preferences because Arrow is “seeking to model democracy” (1977, cited from 1984 p 167). Voting - whether for election to an office, a government, a social organisation, a labour union, or a business - is seen as a pure case of social choice in action, in that a voting scheme aggregates individual preferences into a social choice. The theory is therefore a theory of elections and legislative choices. The point at issue is to design a constitution which leads to consistent social decisions and which also reflects the decisions desired by the members of a polity.
Arrow formulated five conditions to be imposed on constitutions and investigated the extent to which they can all be satisfied. These conditions may be summarised as follows. Firstly, the social choice system is required to have the same structure as that assumed for individual value systems; that is the social choice must completely rank all alternatives presented for consideration and all rankings must display the property of transitivity (condition of collective rationality). Secondly, individual freedom of choice must not be restricted and the collective choice process must be capable of reaching collective decisions for all logically possible individual preference orderings of the alternatives (condition of unrestricted domain). Thirdly, the social choice process must solve the problems posed by instances of market failure. If an individual preference is unopposed by any contrary preference of any other individual, this preference is preserved in the social choice (Pareto principle). Fourthly, social choice over a set of alternatives must depend on the orderings of the individuals only over these alternatives, and not on changes in the ranking of other social outcomes. Only preferences among the available candidates are to be used in deciding an election. If Adams and Black are the only two candidates, it should not make any difference what voters think of Clark (independence of irrelevant alternatives). Fifthly, there should be no individual such that, whenever he prefers \( x \) to \( y \), society prefers \( x \) to \( y \) irrespective of the preferences of everyone else (non-dictatorship).

Conditions one, two and three concern how the social choice rule works over a given array of individual preferences. Conditions four and five, on the other hand, concern the workings and the responsiveness of the rule to variations in the array of preferences. For instance, condition five says that if an individual’s preferences differ from those of everyone else, society should not make decisions on the basis of that individual’s preferences. Arrow, as well as subsequent contributors to social choice theory, proved that no constitution exists which satisfies all five conditions, and that under conditions one through five, there is no method to sum the individual preference orderings into a collective preference ordering (Arrow’s Impossibility Theorem). In this respect “the main results of the theory have so far been negative”
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(1977, cited from 1984 p 162) and no system of voting, however sophisticated, can satisfy all conditions. But if any one of the conditions are dropped, a solution exists.

Majority voting, for example, does not necessarily satisfy the first condition when there are three or more alternatives. Whether it works depends on the structure of individual preferences; therefore it applies only to a restricted domain of preferences, thereby violating condition two. Majority voting produces a consistent ordering when preferences are “single-peaked”. This corresponds to the case in which the alternatives can be so arranged on a line that everyone’s intensity of preferences has one peak only (i.e. movement away from the most preferred outcome in any direction, leads to constantly falling utility). However, if this condition is violated and preferences are “double-peaked”, a social preference cycle will emerge thus violating the condition of collective rationality. Consider also the following example. There are three alternatives, x, y, and z, among which choice is to be made. One-third of the voters prefer x to y and y to z, one-third prefer y to z and z to x, and one-third prefer z to x and x to y. Then x will be preferred to y by a majority, y to z by a majority, and z to x by a majority (Arrow 1985b p 143). The transitivity postulate forces a choice among the three alternatives if the social choice process is not to be left indecisive. “But with the information at hand, ...., there is no method for making such a choice that is not imposed or dictatorial” (Mueller 1989 p 387).

A considerable literature exists which interprets both the basic meaning of Arrow’s theory and the specific conditions included in it. Mueller, in his survey, emphasises the normative content of the theory and argues that the conditions indicate “the basic value judgements to be incorporated in the community’s social contract or constitution” (Mueller op cit. p 385). However, a purely normative interpretation seems to be too restrictive. The condition of non-dictatorship is a normative statement but views about dictatorships are not developed in abstractum, but also on the basis of positive knowledge about what dictatorships can imply. A broader interpretation is advocated by Sen (1987) who argues that the positive contribution of the negative impossibility result presented by Arrow has been to focus on the principles of social choice. Social choice theory invites attention to the
contents and acceptability of basic principles of choice as well as their plausibility for analyses of welfare issues. Sen argues that “it is more in the context of political decisions involving a few diverse alternatives (rather than welfare economic judgements in general) that majority rule and related decisions have some *prima facie* plausibility” (Sen op cit. p 385). A similar emphasis on both normative and positive aspects of social choice theory is argued by Inman who discusses Arrow’s theorem in the context of the conditions for efficient government. He finds that conditions one, two and four “all have convenient interpretations as means of ensuring an efficient decision-making process. They seek to ensure that societal decisions will in fact be made when individuals can provide the required information for collective choice, and that that information will be used as parsimoniously as possible” (Inman 1987 p 682).

More specialised examinations of social choice theory are concerned with the problem that to keep alive the possibility of a reasonable social choice rule, it is necessary to weaken one (or more) of Arrow’s conditions without losing the entire content of the theory. Doing away with condition one removes the whole point of the exercise as does the removal of the Pareto principle (condition three). Imposing a dictator has been deemed undesirable in the literature. Alternative procedures to the pairwise voting procedure stated in condition four leads to further complications (Inman op cit pp 689).

Most modifications of Arrow’s theory have focused on condition two. Experimental work on majority rule cycles reviewed in Mueller (1989 pp 80) and in Van den Doel and Van Velthoven (1993 pp 99) indicate that the probability of a cycle occurring decreases as voter preferences become more homogeneous, and increases with increasing voter diversity. In certain practical situations, the domain of preferences which needs to be considered may be restricted. This result can be interpreted as having two partly different implications. Firstly, it “provides an insight into the significance of the political culture for a democracy” (Van den Doel and Van Velthoven op cit. p 105, their italics). A certain degree of consensus with regard to the norms, values and goals in a society is necessary for democracy to work. Secondly, the result suggests “searching for ways of restricting membership
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in the polity to those with sufficient homogeneous or complimentary preferences to avoid the impossibility result” (Mueller op cit. p 393). Voluntary associations and (to an extent) local authorities allow people to sort themselves into groups with similar tastes. People are, so to speak, voting-with-their-feet when they enter and leave voluntary associations and move between localities with a view to maximising their own welfare.

(b) Constitutional and public choice

As in social choice theory, public choice theorists are concerned with constitutional issues in the context of an attempt to model democracy. The prime point of departure from social choice theory lies in a rejection of the idea of social rationality. In two classic papers Buchanan (1954a, 1954b) questioned the appropriateness of seeing group choices in terms of social rationality with the argument that it is a mistake to impose the logic of individual choice on the procedures of group choices. “Rationality or irrationality as an attribute of the social group implies the imputation to that group of an organic existence apart from that of its individual components” (1954a p 116). In a more recent publication Buchanan stresses that “social objectives”, “national goals” and “social welfare functions” are not part of a properly understood public choice perspective (Buchanan 1986 p 87).

Related to this point is a prescription of methodological individualism which means that the optimal social organisation for a community would be one which generates the most efficient reflection of individual preferences. Whilst orthodox welfare economics finds that the processes by which a particular allocation is achieved does not matter, public choice theory places strong emphasis on decision rules and procedural rules. The constitutional perspective is accordingly characterised by an emphasis on the rules of the social order: “If end states are invariant over shifts in constitutional structure, there is no role for constitutional political economy. On the other hand, if institutions do indeed matter, the role is well defined. Positively, this role involves analysis of the working properties of alternative sets of constraining rules” (Buchanan 1987a p 250).
The notion that attention to rules is important is argued most comprehensively in a recent series of contributions by Brennan and Buchanan in which the “methodology of constitutional economy” is considered among other issues (see Brennan and Buchanan 1985, Brennan 1984, Buchanan 1986, 1987a, 1987b). The starting point for Brennan and Buchanan is that traditional welfare theory lacks a notion of the legal-institutional constraints within which economic and political agents choose. Orthodox welfare economics rests on the presumption that the only constraints on the economy are endowments such as wealth and technologies, a view which Brennan and Buchanan strongly oppose. They emphasise that individuals face choices in a social setting in which the existence and behaviour of other persons, along with the institutions that constrain their behaviour, are much more important than the physical constraints of nature. Economics is not only about the allocation of scarce means to competing uses but also, and more importantly, about the origins, properties, and institutions of exchange (Buchanan 1986 p 20). From this it is argued that “institutional arrangements constrain the set of feasible outcomes no less significantly than the basic physical constraints (“endowments”) that delimit the range of desired end products” (Brennan and Buchanan 1985 p 16). Hence for choice behaviour institutional constraints are as important as basic scarcity constraints.

A further methodological point is developed in a criticism of the framework behind the construction of social welfare functions. Brennan and Buchanan argue that traditional welfare economics has focused too much on constructing normative criteria for selecting a preferred action out of every possible environment. They assert that this endeavour is flawed and that it is misleading to examine the set of all conceivable social outcomes and select an ideal that best fits some independent and external normative criteria. Normative enquiries and considerations of “desirable” outcomes are only relevant if it can be shown that there exists a set of rules which permit these outcomes to be realised. Analysis of the consequences and outcomes of alternative actions ought to be complemented with an analysis of the rules that generate different outcomes. Moreover “any outcome may be acceptable, provided the rules are fair and are adhered to. Alternatively, although outcomes are
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normatively relevant, so too may be the processes that generate them” (Brennan and Buchanan op cit. p 18).

Processes according to certain rules are not of independent value, but they do provide information about the normative status of outcomes (e.g. whether or not they are acceptable, desirable, etc). Analysis of stable rules discloses valuable information about the nature of choice, and the rules under which outcomes are achieved provide a normative basis on which to evaluate outcomes. Because both process and outcome are significant, it is as important to define good decision rules as it is to prescribe “optimal” solutions to particular problems.

In the socio-political context decision rules can be explored from two points of view. It is necessary to separate the process through which the rules are determined from the process through which particular actions within those rules are chosen. These distinctive processes correspond to the issues of the “choice of constraints” as opposed to the “choice within constraints” (Buchanan 1987a, 1987b). Ordinary choices of economic and political agents are made within the constraints imposed by the legal-institutional structures and rules. Traditional economic investigations of policy effects as well as studies of the benefits and costs of policy intervention are mainly concerned with the type of choices that are made within existing institutional constraints. In considering these issues, economics offers a potential advice to the practising politician. In contrast, the ultimate objective of constitutional economic analysis is the choice among the institutions and constraints within which political agents act. It is only through positive comparisons of the working properties of alternative sets of rules and constraints that normative judgements should be made (Buchanan 1987a, 1987b).

It is part of the success of public choice theory that “the notion of rules has - in several different contexts - come to occupy the attention of economists” (Atkinson 1987b p 13; see also Musgrave’s (1984) comment to Brennan). This includes the writings of scholars who are more sympathetic to orthodox welfare economics than Buchanan and associates (see e.g. Sugden 1981, 1993, Sen 1994). However, a rules-oriented framework has so far been missing from standard economic theory of the welfare state. A key component of Barr’s analysis of the welfare state is the
distinction between the aims of policy and the methods available to achieve them and he argues that the proper place of ideological value judgements is in the choice of aims. “*Once these aims have been agreed* the choice of method should be regarded as a *technical* issue rather than an ideological one” (Barr 1987 pp 97-98, his italics). But no consideration is given to the characteristics of the process by which agreement is reached and the extent to which a separation of ideological “objectives” and technical “methods” is useful for policy analysis is open to question. Political choices of an objective, such as poverty relief and income security, are not made without consideration of the possible methods available to achieve them (means-testing, insurance, tax relief).

As argued by Wiseman, “the notion that economists can readily distinguish “ends” and “means” is nowhere more dubious than in the field of social policy (means-testing can be seen as either an end or a means). Qua technician, the economist cannot say that individuals should not attach utility to different procedures: but he can make sure that those involved understand the facts” (Wiseman 1985 p 93). Like means-testing, social insurance can be characterised as both an “objective” and a “method”. Social insurance may be viewed as an efficient method of achieving the aim of providing income security and poverty relief, but it may also be viewed as a fair procedure for deciding benefit entitlements. Provision of earnings-related benefits may be deemed highly desirable by citizens if these benefits are linked to earnings-related contributions. But earnings-related benefits may be deemed highly objectionable by the same citizens if these benefits are financed by tax revenues (whether in the form of payroll or other taxes).

Whereas attention to rules is becoming more widespread in economic theorising, greater controversy surrounds the contractarian-libertarian perspective to public policy analysis which underlies much of the recent work by Buchanan and associates (Congleton 1988). Brennan and Buchanan stress that the relationship between the rules-oriented, or constitutionalist, perspective and the contractarian vision is not a direct one since the constitutionalist need not at the same time be contractarian (Brennan and Buchanan op cit. pp 19). Rather the contractarian vision is developed with a particular American political context in mind. American
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political themes were already dominant in the “Calculus of Consent” which Buchanan wrote with Gordon Tullock in 1962.

In his own survey of the evolution of public choice ideas, Buchanan summarises the themes of this book as “a mixture of positive analysis of alternative decision rules and a normative defence of certain American political institutions that owe their origins to the Founding Fathers, and to James Madison in particular” (Buchanan 1978 pp 9-10). The American political context is also emphasised in the recent work by Brennan and Buchanan who state that their “hypothesis is corroborated by the veneration Americans accord their Founding Fathers” (Brennan and Buchanan op cit. p ix). This view has formed the background for intervention into the political debate about amendments to the constitution and for support for the tax-limits movement. Buchanan’s “efforts have been motivated by the observation that the American constitutional structure is in disarray; the constraints that “worked” for two centuries seem to have failed” (Buchanan 1978 p 16; see also Brennan 1984). For a critique of this view see Musgrave (1984).

However, Buchanan and associates also claim to have a genuine philosophical basis for a contractarian view of the constitution of the social order and government. On a philosophical level the contractarian vision begins from the idea that a political system under which individuals can be coerced by collective decisions can be justified only if those individuals can be said to have consented to being subject to the system. Society is viewed as a process of voluntary agreement among persons and the relevant difference between markets and politics does not lie in the kinds of values and interests that persons pursue, but in the conditions under which they pursue them. Exchange in markets is only one kind of exchange. Politics is viewed as a complex many-person system of exchanges or contracts, and individuals are conceived to join together to establish collective arrangements that are mutually beneficial. This stipulates “unanimity as the contractual ideal” although “on a practical level a requirement for unanimity may seem to be mere utopian romanticizing” (Brennan and Buchanan op cit. p 27). Other kinds of political decision rules, such as majority voting, should only be used when the cost of
reaching unanimity is prohibitive. Broadly speaking, unanimity is required at the constitutional level, but not at the operational level of day-to-day decisions.

Little empirical application of the rules-oriented, constitutional paradigm has so far been attempted, with or without contractarian underpinnings. With regard to political constitutions, Buchanan and associates “do not discuss the process by which the constitution gets written” (Mueller 1989 p 433), and this issue has not yet been investigated elsewhere. As noted in a recent paper by Elster, “there is not, ..., a single book or even article that considers the process of constitution-making as a distinctive object of positive analysis” (Elster 1994 p 1). Investigations of more specific decision rules have also been lacking. The key question of “how alternative political rules might generate differing tax rules” (Buchanan 1987b p 587) needs to be answered on the basis of empirical analysis.

Finally, as we have seen in a number of contexts, Wiseman argues for a public choice cum contractarian perspective in the analysis of the welfare state. However, he limits himself “to suggest directions of development, by attempting to identify some of the interesting new questions to which the proposed approach directs attention” (Wiseman 1991 p 67). The Wiseman story implies primarily an argument for taking proper account of citizens’ preferences and “caring feelings” in policy analysis, and a systematic investigation of decision rules and procedures, the sine qua none of any rules-oriented paradigm, is not undertaken. Comparisons of, for example, alternative sets of rules determining finance and delivery of welfare benefits need to be included in further public choice research into the functioning of the welfare state.

2.9 Multi-level government and provision of social security

Both Arrow’s social choice theory and Buchanan’s “constitutional economics” focus on normative issues of optimal constitutional design, a situation which to an extent explains the limited empirical application of the theories. This also means that the theories can only serve as starting points for analysis of the issues that were raised at the beginning of section 8 regarding the establishment of a “framework on choice” and the link between systems of government and social security.
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Constitutional choice, in the context of social and public choice theories, concerns choices about the features of the political process. Both theories are concerned with modelling democracy and with rules which order the relationship between citizens and government. Government is viewed as one entity.

This focus is in line with the fact that economic theory has been concerned mainly with the choice between market and non-market allocation of goods and services. To provide a comprehensive theory of “constitutional choice” in the design of welfare systems, it must be acknowledged that there are numerous decision makers involved in welfare provision and that the structuring of the governance as well as the funding and delivery of social security vary significantly between countries.

Existing welfare state theory has tended to pay only scant attention to these issues. In Barr’s theory of the welfare state, any organisation bar private profit-making firms supplying actuarial insurance is put in a black box labelled “government”. The absence of a theory of governance structures is a general weakness of economic theory. “It does not tell us whether a function should be performed by a local, state, or central government, by an ad hoc authority or organisation, by an international organisation, or by some other type of institution. Neither does any other discipline have a theory which can be of general use here. Perhaps in part because of the lack of a good general model, there is a wide range of thought (or ideology) on this subject” (Olson 1969 p 279). In this section we consider literature which attempt to overcome this deficit by investigating the assignment of social security provision to different levels of government. Consideration is given to how the assignment of policy functions relates to the political process.

(a) Fiscal federalism

Oates’s theory of Fiscal Federalism provides the usual starting point for empirical investigations of the structure of government, although the term fiscal federalism is slightly misleading in that it should not be understood as a theory which only applies to countries with federal political systems. “In economic terms, all
governmental systems are more or less federal; even in a formally unitary system, for example, there is typically a considerable extent of de facto fiscal discretion at the decentralized levels. Instead of being dichotomously federal or nonfederal, governments vary along some multidimensional spectrum in the degree to which fiscal decision-making is decentralized” (Oates 1977, cited from 1991 p 22). Oates finds it more useful to define a “centralised solution” to the problem of resource allocation as one that emphasises standardised levels of services across all jurisdictions. A “decentralised solution” stresses greater scope for decentralized choice in the provision of these services.

In developing his approach, Oates follows Musgrave’s distinction between the stabilisation branch, the distribution branch, and the allocation branch of government (see Musgrave 1959, and Musgrave and Musgrave 1989 pp 445). Policies affecting macroeconomic stabilisation and the distribution of income must rest with the central government. Local fiscal units will be ineffective in dealing with unemployment or inflation, because markets are interrelated and policy action in one jurisdiction will affect others. Similarly, the mobility of people among different localities places fairly narrow limits on the capacity for local income redistribution. Decentralized choice in the public sector comes into its own in the allocation of local public goods. The case for decentralisation in the provision of local services is linked to the proposition that the cost should be borne in the jurisdiction in which the benefits are reaped. For example, the construction of sea defences benefits those protected by the sea wall; the transmission of a television programme benefits those within a certain distance of the transmitter (Atkinson and Stiglitz 1980 p 519).

Oates’s distinction between centralised and decentralized solutions is useful because it emphasises similarities between countries. Even a dictatorship needs an element of decentralized decision-making. Variations between policy systems can then be analysed in terms of the degrees of centralisation and decentralisation which are applied. On the other hand, as we have argued in previous sections, efficiency and distribution are too interlinked to be separated and the Musgrave-Oates argument for assigning redistributive policy making to the national level rests on a
rather sharp separation of efficiency and distribution, which may be considerably less straightforward in practice. As argued by Hughes and Smith, “the standard model of fiscal federalism is not appropriate for Europe.... Central governments have found it convenient to use local governments in order to devolve the administration of public services and redistributive activities including education, social welfare, social housing and health care. While local management of such functions improves the match between consumer preferences and expenditures, these cannot be accurately characterized as local public goods” (Hughes and Smith 1991 p 452).

(b) Principal-agent theory

Several writers have argued for an alternative model for analysing the spectrum of centralisation-decentralisation in the public sector which is based on the principal and agent view developed in the literature on firms and large organisations (see e.g. Helm and Smith 1989, Hughes and Smith 1991, Levaggi 1991, 1993). In this model, central government is the principal and lower tiers of government are agents. Central government can delegate tasks to subsidiary authorities and/or it can allocate its various functions among different national departments augmented by local or regional subbranches (Helm and Smith op cit. pp 285). Decentralisation is a method by which better information can be gathered and processed at a lower cost than would be possible with a fully centralised organisation. The risk of decentralisation is that local agents may choose to pursue their own objectives rather than those of the centre. “There is thus a trade-off between the informational gains from decentralisation and the weakening of central control” (Helm and Smith op cit. p 286). On this view “the distributional priorities of government are most appropriately set at national level, but the information requirements of administration may mean that implementation would be more efficient at a lower level of government” (op cit. p 287). In this context, the decentralised functions can be performed either by a decentralized bureaucracy or by local government.

The advantages to central government of choosing a bureaucratic solution would be that it would more effectively secure the implementation of national priorities.
The advantages to central government of choosing local government would be that local voters may have a greater capacity to evaluate relative performance and exercise control than central decision-makers. It is here assumed that the interests and preferences of local voters broadly coincide with the preferences and objectives of central government. To the extent that the objectives of central government and local voters differ, the value of elections as a control device is reduced and central government would be better off in choosing the bureaucratic solution.

The usefulness of the principal and agent model depends on the extent to which the actors can be clearly defined in practice. Although the model may help explain features of highly centralised policy systems, it may be less helpful in understanding systems where decentralized solutions form an integrated part of the polity. The model appears to have been developed with recent UK experiences in mind, in particular recent reforms of welfare provision which have aimed at injecting decentralized choice into the UK welfare state system. Maynard describes the reform process leading to changes in the National Health Service. “The decision to reform the NHS was taken unilaterally by Prime Minister Thatcher and announced, to her cabinet colleagues’ surprise, on BBC-TV in January 1988. The discussion of the reasons for reform and the options for reform took place in a small group controlled by the Prime Minister which met in secret. After six months, during which the focus was on demand side reform....., the Health Minister was replaced and the focus of reform switched to the supply side” (Maynard 1992 p 6). This reform process may reasonably comply with the view of a (benevolent?) principal having the freedom to make her own choices.

In other policy systems decision making is far more complex and it is not obvious who is the principal and who is the agent. In the federal system of Germany the relationships between the federal, state and local tiers of government are more complex and decision-making is more entwined: “the old sophisms and subtleties about whether the federal government, the state government, or both are sovereign and autonomous are outmoded. No level of government is completely sovereign any more, ...” (von Beyme 1991 p 335, see also Bös 1989). Both in the day-to-day operation of government and in the case of the process and implementation of major
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reforms numerous political agents play a part and have to be taken into consideration. Hence, there is no clearly defined principal.

Furthermore, the model describes the relationships between the different levels of government in entirely administrative terms leaving the constitutional-institutional environment unexplained. Helm and Smith finds that “the actual pattern of decentralized decision-making in the UK may be largely a matter of historical accident” (Helm and Smith 1989 p 288). In the absence of an investigation of the constitutional-institutional environment, the focus of analysis tends to become short-term. If lower level government pursue strategies which are deemed undesirable and inconvenient for central government, the principal can correct for them at will, subject to the constraints (information, control) inherent in large organisations.

The level of constitutional choice needs investigation, since the constitutional-institutional environment constrains the choices which are open to any centralised authority, even dictatorships. In Stalinist societies, the use of markets was ruled out at the constitutional stage, so market solutions were not an option for central government, which was thereby constrained in choice. In the Third Reich, the market remained in operation and was used by the regime. But democratic institutions such as local government, trade unions and professional organisations, self-governing social insurance organisations, etc were abolished at the constitutional stage. If the Nazi-principal would have wanted to use say local government in the service of the nation, the Aryan race, or his own self-interest, he would have had to reinvent it, thereby establishing a new constitutional environment. Constitutional-institutional choices also determine the positions of the different political actors in pluralistic, democratic societies. On the basis of an analysis of these issues, the strategies and behaviour of the different levels of government can be investigated and the emphasis on short-termism can be overcome.
2.10 Features of social security reform

The notion of fiscal federalism and the principal and agent model provide a basis for investigations of the structure of government; but the insights afforded by these theories need to be supplemented with a theory of the political process and the significance of stable and constraining decision rules. A rules-oriented, constitutional approach is called for and would imply modelling these issues in terms of “constitutional” or institutional choices. In using the term “constitutional” we follow the analytical definition provided by Buchanan: “By constitutional in all this discussion, I mean only to refer to rules and institutions that continue in being from period to period, independently of choices made within periods. I am not concerned with semantics” (Buchanan 1968 p 160). We are primarily concerned with the positive implications which follow from a rules-oriented, constitutional paradigm and do not consider the normative-libertarian deliberations which have occupied Buchanan and his followers in recent years.

A positive theory of institutional choice, as an integral part of a positive theory of public finance, is essentially empirical. “Painstaking accumulation of the record of historical experience, careful presentation of descriptive detail, and comparative analysis: these are all necessary” (op cit. p 201). This necessitates examination of case-studies of major social security reforms with a view to detecting how choices between institutional arrangements and between alternative sets of constraining decision rules are actually made.

According to Buchanan, a positive theory of public finance must ask the following questions: “How do publicly supplied goods and services get organised in large-number groups? Who decides, and on what basis, which goods and services are to be publicly supplied? Who decides, and on what basis, how much of each good and service to provide? Who decides, and on what basis, how costs are to be shared among members of the community? Who decides, finally, on who is to decide?” (Buchanan 1968 p 200). Buchanan’s list is almost open-ended. In more operational terms a constitution may be defined as a configuration of “decision rights”. In welfare state analysis the chief decision makers are central government,
local authorities, self-governing social insurance institutions, and private organisations.

A constitution defines the relative importance and autonomy of these decision makers. What in orthodoxy is described as the “assignment of functions” at the hands of central government, needs to be analysed as the “assignment of functions” through the political process. Decision makers possess rights to make decisions over funding and delivery of social security but they must follow certain rules and procedures.

Several observations in received public finance theory can be interpreted on the basis of a rules-oriented framework as a question of decision rules and procedures. The distinction between revenue grants, assigned taxes, and locally controlled taxes is essential. “When grants are paid by the central government it will be concerned with how they are spent” (King 1993 p 171). Equally important is the distinction between taxes and social insurance contributions which can be analysed on the basis of Buchanan’s theory of earmarked taxation (Buchanan 1963, 1967 pp 72). Depending on the institutional features and the degree of revenue segregation, social insurance contributions can be viewed as a special case of earmarked taxes (high degree of revenue segregation in Germany and Denmark) or as a general tax (low degree of segregation with national insurance contributions paying for several quite diverse contingencies in Britain). On the basis of these considerations a number of features of social security reform can be brought out.

In many countries compulsory social insurance emerged at a time when democracy was under-developed. The German sickness insurance scheme was established in 1883 and the national old-age and invalidity pension scheme was introduced in 1889, but universal suffrage was only implemented in 1919. In Britain, the introduction of a state pension in 1908 and national social insurance in 1911 preceded the Representation of the People Act of 1918, “which tripled the size of the electorate and gave the vote to women over thirty and to all adult males other than peers, criminals and lunatics” (Harris 1990 p 74). In both countries, compulsory social insurance was met with opposition from those already covered by voluntary arrangements.
In parliamentary democracies, most fundamental social security reforms appear to have been based on a principle of relative unanimity and implemented with large majorities in parliament. With regard to the British Beveridge reform, Barr notes that “the 1945 Labour government was armed with a large Parliamentary majority and a stack of White Papers, many of which had met with Conservative approval during the wartime coalition” (Barr 1987 p 30). In Denmark, “the social reform” refers to a sequence of social security legislation implemented during a ten year period from the mid 1960s to the mid 1970s with the overall aim of establishing a unified framework for the provision of social security and social welfare (see e.g. Rold Andersen 1970 chapter 2, 1973 chapter 10; Plovsing 1990 pp 70). Different parties were in power during this period and the reform process was continued when conservative parties were in office from 1968 to 1971. All measures were considered and planned in tripartite Royal Commissions, whose work was backed by academic studies.

In the extreme conditions of the inter-war Weimar Republic in Germany, major reforms were also passed with large majorities in parliament. The establishment of a national system of unemployment compensation in 1927 proved to be “the highlight of the development of social policy in the Weimar Republic” (Adamy and Steffen 1982 p 276, see also Hentschel 1987). The creation of the system was the outcome of a lengthy process of reform which had started in 1919. During this period Germany saw no less than fourteen changes in government and no party had an overall majority. However, an “unofficial coalition” between all major parties was formed and legislation was passed in July 1927 with 355 voting for and only 47 voting against the bill (Führer 1990 p 189). In all these cases, the disadvantages identified by social and public choice theorists of simple majority voting seem to have been overcome, at least to an extent.

Finally, restructuring of the governance and “decision rights” as well as changes in the funding and delivery of social security have been significant features of major social security reforms. This has concerned firstly the assignment of governance to different levels of government. In Scandinavia and Germany national legislation in the inter-war period set out to regulate and to an extent standardise the provision of
means-tested welfare pay, but its provision remained a local activity allowing for a considerable degree of discretion within the national framework. In Britain, the provision of means-tested welfare was a local undertaking until 1934 when a centralised system was introduced.

Secondly, social security reforms have been concerned about assigning functions to a variety of social insurance organisations. In Britain, this has led to social insurance becoming fully integrated into the state system whereas in Germany, ever since the original legislation, the governance of insurance has been shared between autonomous self-governing social insurance organisations and the central federal government. In Denmark, as in Sweden, reforms have created a system where voluntary unemployment insurance is governed jointly by trade unions and central government. Thirdly, linked to these differences in governance and “decision rights” are variations in the rules determining funding and delivery. Local discretion on taxes allows for local discretion on means-tested welfare pay in Denmark and Germany. Voluntary insurance implies voluntary contributions and benefits linked to contributions, which is unique in a system such as the Danish which is generally based on tax-financing of social security. British national insurance contributions are paid into one unified charge fund which covers unemployment, sickness, invalidity, pensions, etc. By contrast, in Germany social insurance is divided into separate branches and organisations, each of which are financed by earmarked contributions and dealing with a particular contingency (health, retirement, unemployment, etc). Provision of insurance benefits in Britain is subsumed under the aim of creating a national minimum of social welfare. In Germany, the aim of insurance benefits is to replace earnings of members of the insurance schemes, a function which in Britain is performed by private schemes.

2.11 Global and spatial comparative perspectives

We shall complete this paper with a methodological note. Comparative cross-country research of state intervention can of course investigate numerous theoretical and empirical questions and it is not the place here to list all possible issues that could benefit from a comparative perspective. Our aim has been to consider a
framework that can help understand the working of diverse policy systems that are basically aimed at the same socio-economic problem (e.g. unemployment compensation and unemployment, health care and health, etc). We have looked especially at providing concepts which can be used in analyses of those basic institutional frameworks that do not change - or only change little - over long periods of time and we have paid less attention to concepts aimed at analysing day-to-day changes in legislation and administration.

Choices of policy framework depends on a large number of factors, a point noted by Atkinson and Hills in their cross-country study of social security and child support. They find that “the social security systems of Britain, France and the US are in themselves illustrations of the way in which different traditions, objectives, and constraints lead to varied solutions to the problem of social security. What is more, they are embedded in an economic and social context that differs significantly between countries, as exemplified by the provision of health care, an issue that is closely related and for which policy is often formulated in the same ministry” (Atkinson and Hills 1991 p 91). Because of the many factors influencing social security systems, a case-study approach is the most appropriate one when it comes to analyses of policy choice. By focusing on a limited number of cases, the specific characteristics of the countries and the policy schemes can be taken into account.

On the other hand, the political research tradition suggests that comparative analyses need to utilise both broad-scale investigations of similarities and differences among a large number of countries and contextually richer case studies involving fewer countries and individual schemes (Skocpol and Amenta 1986 pp 151, Heidenheimer et al 1990 pp 9). A global perspective may first of all help in setting up a general stylised point of reference by detecting common features in a large number of countries. It is however important to beware that studies which claim a global perspective often tend to reach conclusions that are based implicitly on an unspecified selection of countries. For instance the study by Gordon (1988), which we discussed in section 2, claims a global perspective, but she appears to reach conclusions only from the situation in North America and certain European
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countries - despite the wide selection of countries in her sample. Similarly, a study by the ILO (1984) on the evolution and the future of the welfare state in general seems valid primarily for Germany, Britain, Scandinavia and other Northern European cases.

The conclusion is that it is important to be more careful and explicit in selecting the sample of countries that are to be explored. In addition, large scale studies of many countries tend to lack sophistication as regards the definition of the empirical issues and the variables that are investigated. Without a careful examination of data sources it is obviously difficult to examine similarities and differences among the countries in a sample.

In what follows we consider two alternative economic approaches which aim at investigating large samples of countries. We first consider the research which has developed in relation to the LIS data base. This research has mainly been concerned with distributional issues. Next we consider research by the OECD as well as by users of OECD material. This research concerns several issues, including the institutional features of compensation systems, the effect of compensation on income, and patterns of unemployment.

(a) Multi-country studies of distributional issues

Empirical research into the distributional effects on living conditions of government intervention in individual countries has made tremendous progress in the last decade with the construction of complex tax-benefit models which can be used for policy evaluation (Atkinson and Sutherland (eds.) 1988 and Sutherland 1991). The models achieve great accuracy in determining how specific policy parameters and even small changes in these parameters affect the conditions of various groups in a single country. Steps towards reaching similar levels of sophistication in comparative research have been made with the construction of the Luxembourg Income Study (LIS) databank on income and its components (Smeeding et al (eds.) 1990). A main difficulty facing cross-national research is the lack of accuracy with regard to the understanding and modelling of institutions in different countries and the lack of adequate comparative data. To determine with any certainty the specific
effects of policy in any one country is an extremely complex exercise and to attempt to draw comparisons between countries increases these difficulties.

Some of these complications have been tackled with the construction of the LIS databank. The databank is based on household surveys whose information has been standardised as far as possible by the LIS research team. By the beginning of 1989, the LIS project contained microdata sets from ten countries. All datasets have detailed information on income (by source), taxes, and household or family composition. The data refer to a year around 1980, with the British Family Expenditure Survey from 1979 and the German Transfer Survey from 1981 included. A second round of datasets for the mid 1980s are currently being added to the 1980 databank, permitting comparisons over time as well as across countries. Thus in Spring 1992 the datasets for five countries referring to the mid 1980s were ready and utilised for comparative research (Green et al 1992).

Hauser (1987) argues that the novelty of the LIS research arises from its use of a group-by-group approach rather than a system-by-system approach. The latter approach focuses on the institutions and transfers constituting the social security system. In contrast to this, the group-by-group approach starts with an empirical description of the living conditions of selected groups and looks for the influences of various determinants, including social security benefits and taxes. Hauser argues that the group-by-group approach is superior because it focuses on the outcomes rather than the institutional frameworks of policy. It is therefore better suited to detecting important interdependencies of policy variables as well as of private actions influencing the welfare of the population. For instance, the lack of provisions for minimum entitlements to unemployment insurance benefits in some countries may be counterbalanced by entitlements to welfare pay as well as by greater commitment by family members in the provision of basic welfare.

Indeed, the LIS research has so far concentrated on analyses of the outcome of policy and less attention has been paid to the design and the specific characteristics of policy schemes. The LIS data have been used for multi-country research relating to income distribution and redistribution, poverty, retirement, etc (Smeeding et al (eds.) 1990, Mitchell 1991). Additional research, as reported regularly in the
“Review of Income and Wealth”, has explored issues relating to the sensitivity of various income inequality and poverty measures to choice of equivalence scales (Buhmann et al 1988) as well as the developments in the earnings distributions between the early 1980s and the mid 1980s (Green et al op cit.).

However, the fact that the LIS research has hitherto concentrated on comparing the living conditions of selected groups across countries should not lead one to conclude that analysis of policy design is not important. Rather, it is a challenge for ongoing and future research to construct an explicit policy database and to disentangle the economic, social, political, and institutional factors that cause differences in outcome (Atkinson 1990b, O’Higgins et al 1990).

The group-by-group approach may be particularly useful in showing the total performance of a nation in preventing such things as poverty and it may also be the best framework for analysing the diversities in policy mix between countries. But if the aim is to analyse the design features of policy the system-by-system approach seems more appropriate in that it focuses on the principles and the constraints of the systems. In addition, in countries of great similarity the two approaches may not be mutually exclusive but differ only in emphasis. For instance, Britain, Germany, and Denmark are sufficiently similar in their unemployment compensation frameworks that it is possible to combine the study of the unemployed as a group and the workings of the main schemes affecting this group without giving a complete account of the entire tax-benefit system as well as of all possible private sources of income.

(b) Multi-country studies of unemployment compensation

A different approach to cross-national research which is particularly relevant for comparisons of unemployment compensation systems and patterns of unemployment is the one followed in the OECD Employment Outlook. The Employment Outlook has been published annually since 1983 and already the first issue included a chapter on long-term unemployment in a large number of countries, and the second issue contained a chapter with calculations of family income replacement ratios (OECD 1984). As in subsequent issues of the Outlook
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(e.g. the 1991 issue), the ratios are calculated for a range of hypothetical cases of unemployment and family structures and they illustrate how the unemployment compensation systems work in principle. The OECD studies bring together a tremendous amount of information which is of value in its own right. However, they are less concerned with comparisons between systems than with making broad generalisations relating to a particular issue.

The OECD investigate various aspects of unemployment compensation and the labour market along topical lines with information and data from a large number of countries. The investigations have a very high degree of subdivisions. For example unemployment benefit rules, the fiscal costs of unemployment compensation, and analysis of structural features of unemployment (long-term unemployment, definitions of unemployment, etc) are treated in separate and unrelated chapters and issues of the annual Outlook. This approach does not allow a comprehensive comparison of systems and countries to emerge.

The information provided in the OECD Employment Outlook is particularly useful for studies which wish to follow a global perspective to the analysis of unemployment compensation and other issues. However, given the present state of international knowledge, the global perspective may lead to inaccurate information and impressions about how policy systems work.

Unemployment compensation is investigated in chapters 3 and 4 of the 1988 Employment Outlook. The OECD claim to include in their definition of unemployment compensation “all kinds of schemes which involve cash benefits for unemployment, except early retirement” (OECD 1988 Employment Outlook p 88). However, both with regard to the German and the Danish cases, the OECD treatment of unemployment compensation does not fully justify this definition. Neither the descriptions of the benefit systems (chapter 4) nor the expenditure data (chapter 3) mention and include the German and the Danish means-tested social welfare schemes. Yet, in both countries the means-tested systems are immensely important in that they provide a social safety net for people in need, including unemployed people in need. The issue of unemployment compensation is addressed again in chapter 7 of the 1991 Employment Outlook. Here the means-tested Danish
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system is included in the descriptions of benefit systems (table 7.A.1 pp 228-229) but no account of it is taken in the expenditure data (page 240). The German means-tested scheme is still not mentioned.

(c) Limitations of multi-country studies

The difficulties and limitations of the large scale OECD approach to unemployment compensation is made quite clear in the Employment Outlook, in which the obstacles impeding attempts to standardise and classify information and data from different countries are repeatedly emphasised. “As with interpretations of all data aiming at international comparability, it is important to avoid misinterpretations and false conclusions. It is necessary to take full account of the underlying concepts, methods and definitions applied in gathering and presenting data” (OECD 1988 Employment Outlook p 84). However, these difficulties are not always emphasised sufficiently by analysts using the OECD information. Thus Layard et al describe the Swedish system as unique because “benefits for the unemployed run out after 14 months, but linked to this are labour market policies to make sure that people find productive work” (Layard et al 1991 p 63). They argue that the peculiar Swedish unemployment compensation and manpower system is the main reason that Sweden has experienced much lower rates of unemployment than other Western European countries in the 1980s.

Moreover, in Layard and his colleagues’ recommendations of policies to cut unemployment, the Swedish example figures prominently as a model for others to follow - in particular Britain (see e.g. Layard et al op cit. pp 449, 473, 476). On a more general level they find: “Unemployment will fall if unemployment benefits are of limited duration and subject to stronger job-search tests. But there is also a strong efficiency case for manpower policies designed to enhance the employability of unemployed people. These should include targeted adult training, quality placement services, recruitment subsidies for the hard-to-place, and (as a last resort) guaranteed temporary employment to people unemployed over a year. Without active manpower policies, harsh benefit regimes have undesirable distributional effects” (Layard et al op cit. pp 508-509). These policy recommendations have been
met with much acclaim in the British press and were repeated in several leaders in the Economist newspaper during 1991 and 1992.

Yet there are reasons to qualify the statement that benefits are of limited duration in Sweden and that the Swedes apply stronger job-search tests than other countries. Layard et al can only reach this conclusion because they ignore the Swedish means-tested system, which is an essential part of the Swedish welfare state providing a basic safety net. Layard et al base their statement about Sweden partly on the OECD 1988 Employment Outlook and partly on information from the US Department of Health and Social Services. However, in common with the Danish and German cases, the 1988 OECD Employment Outlook ignores the means-tested welfare pay scheme in Sweden, although the scheme is included in the description of the Swedish system in the 1991 Outlook. Yet, the means-tested scheme is not of minor importance, a fact which has been well documented in the Scandinavian literature (see e.g. Nordisk Råd 1983, which includes an appendix with three chapters that are translated into English).

In the period 1978-88, the proportion of the unemployed in Sweden who did not qualify for any of the main insurance benefits varied between 24 and 41 per cent (Björklund and Holmlund 1991 pp 122-123). Little information is documented about the characteristics and the income of these people. Thus the “Nordisk Råd” found that “it is true of all Scandinavian countries that those people who are not entitled to unemployment benefits, because they have gone beyond the time limit within which one receives benefits, for example, are supported in very different ways. Thus, some will be able to live off savings or will receive help from the family. Others will be directed to apply for financial help through supplementary benefits.... On these grounds, one should be wary of making generalisations about the situation of those unemployed who are not entitled to actual unemployment benefits” (Nordisk Råd 1983 p 21).

The “Nordisk Råd” considers the situation in the 1970s and early 1980s. However, with reference to Sweden in the 1980s, Björklund and Holmlund reach a similar conclusion: “Unfortunately, we do not know to what degree those who lack unemployment compensation receive public welfare payment. There is also a lack
of information about combined benefits (unemployment compensation and welfare payments). Our empirical knowledge about the income situation of the unemployed is consequently rather deficient” (Björklund and Holmlund 1991 pp 124-125). It is clear that by omitting a discussion of the arrangements for these groups, there is little justification for the statement by Layard et al that benefits in Sweden run out after 14 months. One might as well say that in 1991 benefits in Britain ran out after 12 months because maximum duration of unemployment insurance benefits in that country was twelve months.

However, what appears to be the case in Sweden - and also in a number of other countries such as Germany and Denmark - is that means-tested benefits are in the main substantially lower than insurance benefits: “The general impression of the financial situation of the group of the unemployed who have to seek social security help, is that their position, on the whole, is much worse than for the group that are insured. In Sweden and Denmark the rates for long-term aid are thus often at a level that is only half as high as that of unemployment benefits” (Nordisk Råd 1983 p 33). Therefore, intensive job search appears to be secured not so much by a threat of a complete withdrawal of benefits nor by offering benefits of limited duration only. The pressure on the unemployed is instead exerted by the threat that they must make do with the less generous means-tested benefits if they do not comply with the strict rules of the insurance system or if they remain unemployed for too long. This is not, however, a peculiarity of the Swedish case but applies also to other countries, such as Denmark and Germany. These considerations illustrate the danger of painting an unduly idealised picture of policy schemes and to jump to conclusions and policy recommendations, particularly as the introduction of benefits of limited duration could have disastrous consequences for large sections of the unemployed in Britain.

In the Layard et al story active manpower policies safeguard against undesirable distributional effects of harsh benefit regimes in that these policies make sure that people find work. However, in this area we would like to raise a few question marks regarding the effectiveness of Swedish labour market policy. As in other countries, Swedish labour market policy consists of a large number of diverse measures. By
far the largest class of measures are “special measures for the disabled” which make up about 45 per cent of total outlay (excluding costs of administration) to active manpower policies in 1987 (see the OECD data reproduced in Layard et al op cit. pp 478-479). Other measures deal with the peculiar Swedish problem of a small population living on a vast territory where remote regions are in danger of being depopulated.

The most important measure in our context however is the guarantee of temporary employment to people who remain unemployed for over a year. This measure, which was introduced in Autumn 1983, is designed with the explicit aim of preventing adverse distributional effects arising from the limited duration of insurance benefits. After a spell of temporary work, the unemployed person again becomes eligible for insurance benefits (Björklund and Holmlund op cit. p 136). As noted by Layard et al, such a measure ought to serve as a last resort, and should only apply to people who have not gained access to training schemes or the regular labour market. But a job guarantee is crucial for the implementation of benefits of limited duration in order to safeguard the weakest groups from falling victim to long-term unemployment and marginalisation.

Yet, it is not entirely clear that the Swedish programme achieve this aim: “Not very much is known about the way this job guarantee works. During the first half of 1984, the National Labour Market Board carried out a follow-up study in three counties. This showed that about one-third of those who could apply for a temporary job did so” (Björklund and Holmlund op cit. pp 136-137). Björklund and Holmlund refrain from speculating about what happened to the two-thirds who did not join the scheme. However, while it is likely that some found jobs on their own and others left the labour market, it is also likely that a substantial group remained unemployed and started living on means-tested welfare pay. But regardless of how many remained unemployed after the termination of unemployment insurance benefits, it is clear that a job guarantee can not replace an unrestricted means-tested scheme which takes into account the welfare situation of the individual and their families.
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On the other hand, it is possible for a job guarantee to be more efficient than seems to be the case in Sweden. A Danish job guarantee was introduced in Autumn 1978. The aim of this measure was not to control and put pressure on the unemployed but to ensure that the long-term unemployed did not drop out of the labour market (Bolle, Peyton, and Toft 1983). In Denmark, the duration of unemployment insurance benefit is 2.5 years. The “Job Offer Scheme” implies that a job of some 6 to 9 months duration is offered to those who are nearing the 2.5 year limit. After a spell of six months of employment, people can claim benefits for another 2.5 years. The Danish measure seems to be more popular than the Swedish one in that 96 per cent of those who were offered a job in 1985 accepted it (Arbejdsdirektoratet, Pressemeddelelse April 24 1986).

One of the reasons for the comparatively high take-up could be that the Danish scheme has been in operation for longer than the Swedish one. The Swedish measure may have been facing starting up problems in 1984 when the survey to which Holmlund and Björklund refer was carried out. Thus in 1980 18 per cent of those who were offered a job in the Danish scheme did not accept (Bolle et al op cit. p 28) and it was only in the mid 1980s that the very high take-up ratios in the Danish measure are first reported (Hækkerup and Pedersen 1987 pp 66).

A methodological implication of the discussion in this section is that it is necessary to complement the various multi-country studies with more comprehensive investigations of a smaller number of countries. At the very least, comparisons between small numbers of countries can help improve our understanding of social security and unemployment compensation by providing more accurate information about the forms and shapes of compensation schemes. As a further methodological point, it should be stated that an important task of national research is to scrutinise the information provided by government. This is also an important task for the international research community when it comes to the data and information published by the OECD. The OECD do not collect their own data but rely on national agencies as well as the international research community to provide information. It ought to be clear that the quality of government information does not improve by being sent to Paris.
2.12 Conclusion

We shall now conclude by briefly summarising the main points of the paper. Society at large and the social sciences have shown an increasing interest in improving the understanding of the role of the state within the economy, with a prominent issue being the particular role of the welfare state. In this paper, we have been concerned mainly with welfare state issues raised within a broad public economics framework but we have also explored issues arising from political science. The two social sciences use different approaches - economics is typically analytical-deductive while political science is typically descriptive-inductive - but both sciences address similar issues. Both try to understand the state as a social institution in its own right and both address the complex issues of the determinants of political choice, the socio-economic organisation of the state, and the impact of diverse constitutional-institutional settings on state action. However, no grand positive theory of the state exists, but rather a set of concepts and hypotheses which attempt to explain aspects of state institutions and action.

Both economics and political science suggest a pragmatic, eclectic approach towards a more adequate understanding of the state, and political scientists in particular advocate the use of cross-country research as a part of their research programme. Empirical political research suggests that diversities between countries tend to persist and that the state plays a crucial role in preserving this diversity. From this it follows that any realistic theory of the welfare state must take as its starting point the heterogeneity of states.

In welfare economics, the state is traditionally perceived as an agent external to the economy. In effect, the state is brought in by the economist to intervene where market forces are unable to fulfil certain social objectives satisfactorily. In the ideal market model, Pareto efficiency arises through voluntary action without any need for public policy. The utility-maximising behaviour of persons and the profit-maximising behaviour of firms distributes goods in such a way that no one can be made better-off without making someone else worse-off. Traditional forms of market failure - monopoly, imperfect competition, externalities, and public goods - provide accepted rationales for such policies as the provision of certain goods (e.g.
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defence) and the regulation of markets by government agencies. However, as argued by writers such as Barr, these failures justify only a residual welfare state. A rationale for more comprehensive welfare state measures is provided by the notion of missing markets, where in the real world markets for some commodities fail to emerge. Efficient risk-bearing may be constrained as a result of adverse selection, moral hazard, or principal-agent problems. The welfare state is an “efficiency device” because it provides goods and services which private markets would not provide at all or would only provide inefficiently in the face of uncertainty and imperfect information.

The welfare economic model of the market economy helps present a general rationale for government intervention, rather than prescribing in detail the specific form such intervention should take. Generally, less intrusive policies (e.g. regulation) are preferred over more intrusive ones (e.g. nationalisation), although in some cases market failure may be so pervasive that nationalisation is preferable nevertheless. Furthermore, as stressed by Stiglitz, the possibility of government failure must be taken into account. In the real world, a variety of nonmarket institutions provide welfare services and different countries have very diverse welfare arrangements.

Welfare economic theory of policy design needs to be developed further so as to compare the advantages and disadvantages of the specific forms of intervention which are found internationally. This includes investigation of the trade-offs between different institutional principles and rules of unemployment insurance schemes (e.g. voluntarism versus compulsion, flat-rated versus earnings-related contributions and benefits) as well as the various links between social security systems and labour market segmentation which can be observed in industrial countries. Both global and spatial comparative perspectives are useful, although currently large scale global studies tend to lack accuracy with regard to the essential features of institutional arrangements in different countries.

In applied work by writers such as Creedy and Disney, a pragmatic approach to analysis of social security is pursued, which assumes that existing policy schemes largely reveal the preferences of policy-makers and citizens in general. The major
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Aims of policy are explored and trade-offs which have been made are identified. Much policy analysis is relatively incremental, and analyses of the features of a country’s system which may need fine-tuning are important, in particular because social security systems are highly complex and often appear to lack coherence in their basic principles.

In a wider context, however, the individual and social preferences underlying the aims of policy must be treated as endogenous. Policy has to be considered in terms of discrete alternatives. The alternative sets of values and methods of social security provision embodied in different countries’ social security traditions can be investigated most appropriately in a cross-country context. Cross-country research in effect looks at a wider set of preferences and a larger opportunity set than does single-country research.

Policy options do not depend only on wealth and technology but also on the establishment and features of a framework on choice. The rules-oriented, constitutional paradigm developed by Buchanan takes us beyond the standard welfare economic model of mixed economies. It is meaningless to talk of competitive markets except within a rules-oriented framework since an economy without rules would be an economy in a state of anarchy where voluntary exchange was impossible. The outcomes of political processes vary with the types of issues decided, the methods of representation, and the voting rules employed. In addition to the features of government behaviour and the wider political structure, emphasised by Atkinson and Stiglitz as necessary ingredients of a “political economy”, analysis must take account of how choices between institutional arrangements and between alternative sets of constraining decision rules are made. This involves *inter alia* comparative investigation of reforms of the governance and the rules determining the funding and delivery of social security.

**Notes**

1) The quote is from the foreword to Musgrave’s book by “The Inter-University Committee on Comparative Economics” which was chaired by Lloyd Reynolds.

2) An examination and debate of this theory is contained in section three of the previous essay in this book.
3) See essay one of this book for a discussion of a selection of segmentation theories.

4) On a visit to the OECD Directorate for Social Affairs, Manpower and Education in June 1988 I gained valuable insights into how studies published in the Employment Outlook are carried out. I wish to thank Mr R. O. Clarke and Mr P. Schwanse for the invitation. Whilst there I had the opportunity to help one of the research officers in charge of describing unemployment compensation schemes to improve her understanding of the German scheme. I hope I thereby repaid some of the great hospitality I met at the OECD.

5) By “social security help” is here meant means-tested social welfare pay as opposed to insurance benefits.

6) In the international research community Sweden also enjoys a reputation for putting more pressure on the short-term unemployed to accept jobs than other countries do. However, this reputation is based on mere anecdotal evidence. Thus the Paris based OECD quotes as evidence a statement from the British Financial Times describing what the Dutch press says about the Swedish system: “Dutch newspaper accounts of the Swedish model are filled with surprised and even horrified reports of how strictly that country applies the rule that the unemployed must accept a job or enter a training programme” (Financial Times, 4 December 1990, cited in the 1991 OECD Employment Outlook footnote 32 page 226).

7) In this connection, it is rather surprising that among the many experts who have commented on Layard et al’s analysis, there appear to be no expert on the Swedish case (see op cit. Preface pp xiv-xv).
3. The regulation of social protection in the European Community: The case of unemployment compensation

3.1 Introduction

The initiation in the late 1980s of the European Community 1992 programme relating to the achievement of a single internal market and the declaration of the European “Social Charter” in December 1989 spell the start of new experiments and developments in the field of social policies (Commission of the European Communities 1985, 1989, Cecchini 1988, Teague 1989). The 1992 programme has generated a vision which sees old barriers for co-operation and competition being broken down and new forms of inter-European social organisation and regulation emerging. Against this background, it is wrong to think of the 1992 internal market programme as tied to the specific date of December 31\textsuperscript{st} 1992.

It is the general vision of new forms of social organisation and regulation rather than the specific policy measures which is the most important result of the 1992 campaign, since many of the concrete measures which are to be implemented by the end of 1992 are not new but in fact a more thorough and determined application of existing legislation and ideas that are already contained in the EC Treaty.

The primary objective motivating the setting of a timetable for the completion of the internal market by the end of 1992 is to speed up integration and remove physical, technical and fiscal frontiers between member states. The removal of these market barriers does not necessarily imply greater involvement in labour market and social policies at the central European Commission level. Indeed the EC Commission’s assessment of the economic effects of completing the internal market includes only few references to such policy issues and measures (Emerson \textit{et al} 1988). Nonetheless the creation of a single market is likely to have a sweeping
impact on national and inter-European labour markets and the ability of member
states to finance welfare state measures. It is in the first instance these (indirect)
pressures on existing socio-economic frameworks that have put social issues on the
inter-European political agenda.

The questions at issue are the extent to which economic integration leads to a
harmonisation and convergence of existing national policy schemes and to what
extent the European Community needs to develop a social dimension and a
common regulatory framework towards social conditions. In this essay I explore
aspects of the emerging social agenda and in particular the implications of European
integration on the regulation of social protection of unemployed workers.

All developed capitalist countries have policies for the specific purpose of paying
compensation to unemployed people. The basic idea of unemployment
compensation schemes is to alleviate the losses in income people experience in the
event of unemployment. With only a few exceptions unemployment compensation
schemes developed much later than schemes aiming at other social contingencies
such as ill health, poverty in old age, etc., which were implemented in the latter part
of the last century and the beginning of this century (see for example Flora and
Heidenheimer 1981, Gordon 1988). But in the wake of the recession and high
unemployment in the 1930s, unemployment became generally accepted as a social
contingency which demanded state intervention and the countries which by then
had not implemented a scheme for the unemployed fell into line and developed such
schemes.

Unemployment compensation is the most controversial of all public transfer
schemes, and pensions, child benefits, housing benefits etc. give rise to
considerably less dispute than support to the unemployed. Much of the controversy
is caused by the close link of the schemes with labour market issues and by the
reluctance of governments to support able bodied workers. Concern about the
implications of compensation on the labour market is also the main reason why
unemployment compensation policies developed much later than other social
security schemes. In the historical context, caution towards the development of state
schemes was not only expressed by governments. Trade unions were equally
reluctant in letting provision for the unemployed become a matter for the state, and trade unions in Scandinavia continue to be strongly involved in administering the schemes.

The controversial nature of unemployment compensation schemes means that it will be difficult to implement a common European framework in this policy area. The EC Commission has considered various options concerning the inter-European regulation of the social protection of workers which include compensation of workers in the event of unemployment. These considerations and options are ambiguous, however, pointing in diverse directions and implying different implications for Community harmonisation and regulation. In what follows I explore the various options under consideration and discuss the role and general framework which the EC might develop in the face of economic integration.

Any realistic “European model” must be based on an examination of the existing models (Emerson 1988b). I therefore start out with a brief consideration of the diversity of European unemployment compensation schemes. Then I examine the ideas concerning the regulation of social protection and unemployment compensation that are put forward by the Commission of the European Communities. Next I explore the forces leading towards harmonisation of social protection given the diverse nature of existing social legislation and traditions in member states. Finally, I outline the policy issues confronting unemployment compensation systems in the wake of European economic integration.

### 3.2 The diversity of unemployment compensation schemes

Unemployment compensation schemes vary widely between different countries. In some countries unemployment compensation is predominantly financed out of general taxation whereas in other countries earmarked contributions play a large role. There are also great differences in the emphasis of the mix between insurance benefits and means-tested benefits. Moreover, some countries pay benefits as a proportion of previous earnings and thereby pay diverse absolute benefits to the unemployed while other countries pay flat rate benefits with all the unemployed receiving the same benefits.
The degree of diversity of European compensation schemes can be illustrated by looking at the basic institutional and economic framework of the schemes in Britain, Germany and Denmark. The starting point is an investigation of unemployment insurance and from this I move on to a consideration of welfare payment schemes. In insurance schemes benefits are paid on the basis of entitlements which in turn are related to contributions paid during periods of previous employment. By contrast, in welfare payment schemes benefits are means-tested and there is no relationship to previous payments of contributions. In reality this distinction does not always hold true. In addition to two measures that are based on the clear-cut distinction between social insurance and welfare pay, Germany has an unemployment assistance scheme in which benefits are related to past records of contributions and at the same time means-tested. In what follows I shall treat this scheme as part of the overall German framework of unemployment insurance provision.

Unemployment insurance schemes are indisputably the “core” schemes in Germany and Denmark. In Germany in 1986 about 46 per cent of unemployment compensation recipients received the “pure” insurance benefits and 42 per cent received the “mixed” assistance benefits leaving only 12 per cent as recipients of welfare payments. In Denmark 80 per cent of compensation recipients received insurance benefits. In Britain, on the other hand, unemployment insurance only plays a secondary role to the means-tested welfare scheme, and in 1986 only about 36 per cent of compensation recipients received insurance benefits. Yet in the evolution of British social security the insurance scheme was regarded as the core scheme for unemployment compensation (see e.g. Dilnot et al 1984) and up until the late 1970s about half of the recipients of compensation were covered by the insurance scheme.

Independent of specific national regulations all types of unemployment insurance schemes have the function of supporting the working population by alleviating the financial risk of unemployment. However, in spite of this, schemes in different countries show fundamental differences in their concrete application of this fundamental principle. The diverse nature of unemployment insurance schemes in
the three countries are shown in Table 1. The three schemes make up a representative sample of schemes that are currently in operation in European countries (OECD 1988).

**Table 1: Unemployment insurance in Great Britain, Germany and Denmark**

<table>
<thead>
<tr>
<th></th>
<th>Great Britain</th>
<th>Germany</th>
<th>Denmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Membership</td>
<td>Compulsory</td>
<td>Compulsory</td>
<td>Voluntary</td>
</tr>
<tr>
<td>Contributions</td>
<td>Earnings-related</td>
<td>Earnings-related</td>
<td>Flat-rated</td>
</tr>
<tr>
<td>Benefits</td>
<td>Flat-rated</td>
<td>Earnings-related</td>
<td>Earnings-related</td>
</tr>
</tbody>
</table>

The Danish measure is one of the few voluntary schemes that still exists and unlike most schemes in other countries contributions are paid on a flat-rate basis. The British and German measures are both compulsory but they represent two extreme forms of providing insurance benefits with the German scheme paying benefits proportional to previous wages and the British scheme paying flat-rate benefits. The basic principles of the measures have not changed since unemployment insurance was implemented in Britain in 1911, in Germany in 1927, and in Denmark in 1907, and there has, therefore, not been any tendency towards convergence of the schemes in the three countries. During the period between 1966 and 1982 Britain experimented with an earnings-related supplement to the flat-rate benefits, but this supplement was very limited in scope with a large number of people not qualifying for the supplement (Atkinson and Micklewright 1985 p 94). The earnings-related supplement was abolished by the Conservative Thatcher government without much dispute.

Most developed countries have means-tested welfare pay schemes which aim at safeguarding the population against poverty. This applies to all EC countries which have means-tested welfare schemes that are organised on the national or local level. In contrast to unemployment insurance, welfare payment schemes are not aimed specifically at the unemployed as a group, but they may nonetheless entail provisions demanding that recipients of working age search for work if they are able to work. There is considerable disagreement as to whether welfare payment
measures fulfil the aim of eliminating poverty and there has been some cross-
country comparative research looking at the institutional set up of policies against
poverty (Walker et al 1984) as well as comparative work measuring cross-country
efficiencies of public transfer systems in reducing poverty (George and Lawson
1980, Heidenheimer et al 1990 p 248). However, the principles of welfare payment
schemes are clear. Their aim is to provide a minimum standard of living for the
citizens of a country, the schemes are financed by general taxation, and benefits are
means-tested.

3.3 The EC Social Charter and the social protection of workers

We shall now examine the framework towards the social protection of workers that
is outlined in the Social Charter and other documents of the European Community.
In the past the most substantial EC initiative in the social area has been carried out
through the Community Structural Funds which aims at supporting the catching-up
process of the less developed regions of the Community and thereby reduce the
disparities in demand and supply conditions in the Community labour market. The
Community’s contributions from these funds are expected to grow to about four to
five per cent or even more of GDP in Greece, Portugal, Ireland, and the poorer
regions of Spain and Italy (Commission of the European Communities 1989a p
168). Whilst subsidies are particularly relevant for the poorer regions, the standards
and the framework for the new social dimension are intended to be modelled on the
conditions in the more developed northern countries (European Documentation
1990 p 67).

It is the object of the Social Charter to create a balance between the deregulation
of inter-European competition and movement of capital and the protection of
workers rights and welfare. The Social Charter is not legally binding for the
member states but as is the case with most measures relating to the completion of
the internal market for goods and capital, the foundations of a social dimension of
the Community is anchored in the EC Treaty - in particular in the Articles dealing
with the free movement of people, social provision and economic and social
cohesion. Provisions of the EC Treaty are legally binding for member states.
In fact, the majority of the planned initiatives of the Commission, as described in the Action Programme for the implementation of the Social Charter, are based on provisions in the EC Treaty (Commission of the European Communities 1989b). The Commission has therefore not changed its Action Programme despite the British government voting against the Social Charter. Many of the Social Charter’s principles can be implemented by way of collective bargaining but other measures need to be implemented by national governments with the EC Commission monitoring progress.

The Social Charter stipulates a number of social rights which will help secure a Community-wide framework to socio-economic issues - but here I shall only consider social protection which is described in section 10 of the Social Charter:

“According to the arrangements applying in each country:

- Every worker of the European Community shall have the right to adequate social protection and shall, whatever his status and whatever the size of the undertaking in which he is employed, enjoy an adequate level of social security benefits.
- Persons who have been unable either to enter or re-enter the labour market and have no means of subsistence must be able to receive sufficient resources and social assistance in keeping with their particular situation.”

The section proposes a dual system of social protection. Whilst the first part is concerned with the right to adequate levels of social security benefits for every worker, the second part is concerned with the right to sufficient resources and social assistance for people who have no means of subsistence. However, the distinctions in the section are broad and ambiguous. It is for instance difficult to interpret the difference between adequate levels of benefits and the receipt of sufficient resources. The interpretation of the section can however be helped by looking at the first two drafts of the Social Charter from May and September 1989. These drafts were substantially watered down in an attempt to please the British government and to persuade it to vote for the Charter but these steps meant also that the final version lacks clarity.
According to the stipulations of the preceding drafts of the Social Charter every citizen of the European Community shall have the right to adequate social protection. Two classes of people and two types of protection are defined. On the one hand there are contributory benefits available to all workers who pay contributions and, on the other hand, there are means-tested benefits available to workers who are excluded from the labour market and the contributory system. These distinctions correspond to the distinctions made in most European countries between social insurance and welfare payments and which I described in the case of Britain, Germany and Denmark in the previous section.

3.4 The Commission’s Action Programme

The Commission’s Action Programme for the implementation of the Social Charter describes the measures which are viewed as the most urgent for the implementation of the Social Charter and delivers an outline of the proposals that the Commission intends to make before the end of 1992. The chapter on social protection in the Action Programme (Commission of the European Communities 1989b pp 27-28) starts out by stating that the social security schemes vary greatly in nature from one member state to another and the harmonisation of the social security systems is therefore illusory. Instead of harmonising the systems the Commission proposes the development of a strategy “for achieving the convergence of objectives pursued by the various governments”.

Social security systems should first of all be prevented from placing a brake on the free movement of labour and from exacerbating regional imbalances. The Commission recommends furthermore the introduction of a “means guarantee” or a “minimum integration income” to help in the fight against the social exclusion of the least advantaged and poorest citizens. Both of these objectives are based directly on provisions in the EC Treaty - in particular Articles 48 to 51 and 117.

The ideas of the Action Programme express a pragmatic approach to the social dimension and the implementation of the Social Charter. The national social security systems shall not be reformed and harmonised and it is up to the member states to find ways of fulfilling common objectives. As noted also in the Action
Programme a right to a minimum income already exists in a number of member states whereas, in some others, it is the subject of regional projects and local experiments. By the same token, none of the member states are completely without a basic means-tested social security system. The Commission is not in the first instance proposing reforms of these schemes but seeking a firmer commitment from member states in grating the schemes a higher priority and in allocating more resources to them.

However, the Commission’s concern about the free movement of labour and regional imbalances contains elements of a more ambitious and far-reaching strategy for the convergence of social protection objectives and policies. This strategy is bound to face considerable complications. A large number of legal and financial issues will need to be resolved if the movement of people between countries is not going to lead to complications regarding the individual’s right to social security benefits. Currently, someone with no job has no automatic right of residence in an EC country other than his own. It would be an even harder task to reduce divergences in levels of benefits which in some cases constitute a brake and in other cases act as an incentive for movements between countries.

The issue of a common type of “means guarantee” is similarly complex in nature when account is taken of the fact that in some countries the family is the main guarantor against individual poverty while the welfare state in other countries plays a much more prominent role in supporting individuals in need. It may be inevitable that in future the level of benefits will vary considerably across countries but it is also most likely to prove very difficult to conquer the diversity in principles and objectives of various national “means guarantees” - at least in the short term. Within a European context this situation raises the question whether it is fair for an individual to be treated very differently depending on the country of residence. For instance, should a British person be excluded from state benefits in Germany, where the family plays a dominant role in providing a guarantee against poverty, when a German person in similar circumstances but resident in Britain can claim means-tested benefits?
By seeking a general consensus from member states in increasing the efforts of integrating the poor, the Commission concentrates on the implementation of the second part of section 10 of the Social Charter, which we quoted above. Indeed, the Action Programme does not manifest any reflections on the implementation of the first part of section 10, which stipulates that contributory benefit schemes should be available to all workers in the Community. The abstention from making specific proposals in this area of social protection is presumably motivated by a concern of giving higher priority to the conditions of poor people.

Whilst safeguarding the poor may be the most pressing aim of social welfare measures, provisions concerning social protection and security for the working population at large play a prominent role in most European countries. In these countries contributory insurance schemes play a crucial role in preventing people from being socially excluded and falling into poverty in the first place. It is a clear possibility that the welfare state measures which aim at protecting the working population at large, and not especially the poor, are most under pressure as a result of the implementation of a single market. This concerns in particular the financing of such schemes as well as the possible relocation of capital away from countries with comprehensive and expensive measures.

### 3.5 Diversity and harmonisation of social protection

The diversity in the fundamental principles underlying social security systems raises a basic concern over the framework of the Action Programme. It is argued in the Action Programme that it is illusory to think of harmonisation of social security systems and one should instead concentrate on a convergence of objectives. It is questionable the extent to which such a distinction between the objectives of the systems and the systems themselves makes sense. Distinguishing between “objectives” and “systems” appears to be motivated by a pragmatic concern of initiating a first step towards the development of a social dimension for the European Community. Indeed, there are obviously several different ways public transfer systems can be designed to safeguard the poor and disadvantaged. But if the idea is to go further than that and move towards a convergence of the wider
objectives of social security systems and to tackle the existing obstacles on the movement of labour as well as regional imbalances it is hard to see how this could be done without a convergence of the framework and principles of social security systems.

It appears impossible to bring about a convergence in the social policy objectives along the lines suggested in the Social Charter, as well as in the more far-reaching and specific proposals in the Action Programme, and at the same time abstain from supervising a harmonisation of the systems. It seems, for instance, impossible to reconcile the objectives of a British style flat-rate system and a German style earnings-related system. In a flat-rate scheme all workers receive the same compensation but in an earnings-related scheme high earners receive substantially more in absolute compensation than low earners. In addition, a voluntary system such as the Danish scheme is based on very different principles than the compulsory schemes that are in operation in other countries in the European community.

It is true, however, as argued in the Action Programme, that national social security schemes “reflect the history, traditions and social and cultural practices proper to each member state”. As I pointed out in the examination of the unemployment compensation schemes in Britain, Germany and Denmark, social security systems show a remarkable stability as regards their basic principles and the evidence suggests that there is no trend towards a convergence of these principles in the different welfare states. Yet the same could be said about almost any area of European Community policy - be it the differences in the roles and regulations of banks and financial services, the variations in vocational training systems, diversity in value added taxes and excise rates, etc.

The Commission’s Action Programme is concerned primarily with achieving the legal bases for the proposals to be made before the end of 1992 but it also sets the agenda for future developments in the social field. Yet the dynamic of social harmonisation is not determined by political initiatives alone but also by the European-wide integration of national economies. Apart from these economic forces, trends towards greater similarities will also come from international
exchanges of ideas as the different member states become more prepared to learn from each other’s arrangements.

The range of factors playing a role in determining social harmonisation is anticipated much more clearly in Article 117 of the EC Treaty than in the Action Programme. In this Article it is anticipated that “the functioning of the common market .... will favour the harmonisation of social systems” but it is also necessary to ensure the “approximation of provisions laid down by law, regulation or administrative action”. When considering the development of a more comprehensive and dynamic framework to the social dimension it should be borne in mind that the legal basis for such a framework exists already in the EC Treaty.

Economic integration and stronger competition is already forcing some countries to rethink the financing and the framework of their social security systems. The need for reforms is reinforced by the harmonisation of indirect taxation and excise rates which is at the centre of the European deregulation programme, and the removal of fiscal frontiers between member states. Hence the demand by the European Community for the harmonisation of indirect taxation has made it necessary to review the whole of the Danish tax and social security contribution system in preparation for the internal market (Rold Andersen 1990, 1991). It is envisaged that social insurance contributions will have to increase in order to offset lower value added taxes. But this could spell the end to the voluntary nature of the unemployment insurance scheme as the working of the scheme rests heavily on state subsidies keeping contributions low in order to attract people with low risk of unemployment. Moreover, if the British government is forced to introduce value added taxes on food and children’s clothing some sort of upwards adjustment of social benefits and low pay will have to be implemented if the poor are not to suffer as a result of harmonisation. It may even become necessary to re-introduce recently abolished legislation protecting people against low pay.

3.6 Outlook: Convergence and regulation of social protection

The Danish and British examples indicate that trends towards European integration of labour market and social policies will have an uneven impact in different
countries depending on how the present policy schemes work. Yet a complete convergence of national regulations and systems is unlikely and probably also undesirable even in the longer term. Even the United States does not have a single unemployment compensation programme covering all states in a uniform manner. Instead the American system is composed of broad federal guidelines which regulate a collection of state-level unemployment compensation schemes each of which has its own eligibility criteria and payment formula (Burtless 1987 p 133).

It is however revealing that when the United States introduced a national scheme in 1935 the initiative came from the federal government. The high levels of unemployment in the 1930s made paramount the introduction of unemployment compensation schemes. But almost all of the US state governments were reluctant to enact unemployment insurance schemes because they feared that their industries would suffer a competitive disadvantage compared with those states that abstained from introducing compensation schemes (Vaughan 1986 p 329). As a result comprehensive unemployment compensation schemes were introduced only when states were forced to do so by federal legislation.

The situation in Europe in the 1990s differs fundamentally from the situation in the United States in the 1930s in so far as that most European countries already have unemployment compensation schemes. However, the economic, political and social changes currently taking place in Europe may become the external force which causes governments - and economists - to consider options which fall outside the scope of present institutional arrangements. The issues are to what extent European integration will lead to a convergence of national social and labour market policies and what principles will govern the new European Community framework to the social dimension? These questions are still open to debate and they can not be fully answered at this stage of inquiry.

The creation of a common market leads to “outside” pressures on and revisions of a large number of national institutional frameworks. Some of these institutions, for instance the central banks, have been in operation for more than a century. There is no reason to exclude in advance the possibility that a revision of national frameworks towards social security would be desirable and perhaps even necessary
if the overall objectives of current national social security schemes are to be maintained, albeit in a modified form, in a future European common market.

It seems clear, however, that a European regulatory framework will have to be developed on the basis of existing national policy schemes and experiences. A spontaneous harmonisation and convergence of national social protection schemes - brought about by economic integration - is most likely to cause high economic and social costs in some countries and it is open to question whether the most comprehensive and beneficial scheme will win the battle over lower cost schemes. A more positive approach towards social protection of European workers will therefore need initiatives and encouragement from the central level of decision-making, which means from the European Commission.

Notes

1) Statistical data from different countries on registered unemployment vary considerably in the treatment of people who are unemployed but not receiving any unemployment compensation. In the figures in this paragraph I have excluded this category of the unemployed from my calculations and I am only taking into account the unemployed who receive various types of compensation. The German figures are calculated from the Bundesanstalt für Arbeit: Jahreszahlen and Klein (1987). The Danish figures are calculated from Danmarks Statistik: Statistiske Meddelelser. The British figures are calculated from the Central Statistical Office: Social Trends.

2) The Treaty is printed in for example Rudden and Wyatt (1986).

3) There are signs that the attitude of the British government has changed with the change of Prime Minister in Autumn 1990. For instance, the British government voted for the Communique from the Intergovernmental Conference on Political Union in Rome December 1990. The Communique contains proposals and concepts – such as European citizenship, social and economic rights, social dialogue, etc. - that are similar to the concepts in the Social Charter.


5) It has been estimated that the EC Commission’s proposal for the harmonisation of indirect taxation will lead to a decline in the Danish government’s revenue of 40 billion kroner or approximately 10 per cent of total revenue (Rold Andersen 1990 p 142).

6) At the time of writing it appears that Britain’s zero rates on food and children’s clothing will be allowed for a transitional period (The Independent Newspaper, 2 June 1991).
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