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Financing Welfare Regimes: A Literature Review and Cluster Analysis

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background paper commissioned for the
UNRISD Flagship Report on Poverty

February 2010 ▪ Geneva

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Table of Contents

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This report builds on Ian Gough's work at the WeD (Wellbeing in Developing Countries) ESRC programme at the University of Bath. The support of the UK Economic and Social Research Council is gratefully acknowledged.

SUMMARY

This report studies how the composition of public revenues in terms of sources (like taxation, contributions to social insurance programmes, mineral rents, aid) is associated with different welfare regimes and social policy outcomes. It is divided into two main halves: a literature review and cross-national data analysis.

The first half uses a model derived from scholarly research into the development of Western welfare states which identifies five explanatory factors, the "5 I's": industrialisation, interests, institutions, ideas and international influences. It applies this to the development of tax and revenue systems as well as welfare systems in the West, and then considers its applicability to the developing world. The conclusion is that the model has less purchase in understanding welfare and revenue systems in the developing world. Here, the patterns of industrialisation, interest formation and representation, institutional development, ideational influences and the entire international environment are very different: more complex, variegated and heterogeneous. Consequently, their ability to explain welfare and revenue systems is more indeterminate.

The second part of this report recognises this heterogeneity by using cluster analysis to identify patterns in welfare regimes and revenue systems across the developing world. It analyses data for 65 non-OECD countries (excluding small countries) for the year 2000, covering welfare regimes, revenue structures, and the relationship between the two.

The hypothesis that higher tax levels are associated with greater state effectiveness in meeting welfare/security needs is not clearly borne out. It is only the scope of *social security contributions* that appears to correlate with proto-welfare states in the developing world. In addition this cluster relies very little on revenues from minerals and oil. This proto-welfare state cluster comprises two distinct geographical zones and historical antecedents: the countries of the former Soviet Union and its bloc members and the relatively industrialized countries of southern South America.

The fast-developing countries of East Asia and some other middle income countries in Latin America and MENA present an interesting anomalous picture in 2000. They exhibit relatively low shares of government social expenditures, revenues, income taxes and social security contributions, yet record relatively good social outputs and welfare outcomes. This suggests that security and illfare are mitigated by other domestic, non-state, informal or private institutions. This group includes several 'developmental states' with considerable infrastructure capacity but which have not prioritised traditional social policies. Here one might expect to see new forms of collective management of risk emerge. Indeed this can already be seen in some of the outliers in this group, such as Turkey, Korea and Chile.

In contrast to this pattern, we observe a small group of countries in southern-eastern Africa with high spending and high tax revenues, but with poor welfare outcomes. This combination partly reflects the damaging effects of AIDS over the previous decade, but not entirely. Finally, the other major world regions, including South Asia and Africa, exhibit weak government and poorly functioning formal and informal security mechanisms.

The report is subject to several important qualifications. Comparative global data on all these issues lags far behind the questions we want to ask. Cluster analysis is an imperfect art rather than a rigorous statistical technique. There are significant outliers in several of the clusters. Finally, the data relates to the year 2000 and thus takes no account of the quite extensive developments in social programmes in some countries over the last decade.

Acronyms List

AIDS	Acquired immune deficiency syndrome
GDP	Gross domestic product
GNI	Gross national income
HCA	Hierarchical cluster analysis
IGO	International Governmental Organizations
ILO	International Labour Organisation
IMF	International Monetary Fund
KCA	K-means cluster analysis
MENA	Middle East and North Africa
NGO	Non governmental organisation
OECD	Organization for Economic Co-operation and Development
UN	United Nations
UNICEF	United Nations Children’s Fund
USA	United States of America
WDI	World Development Indicators

INTRODUCTION

This report studies how the composition of public revenues in terms of sources (like taxation, social insurance contributions, mineral rents, foreign aid) is associated with different welfare regimes and social policy outcomes. It is divided into two main halves: literature reviews and cross-national data analysis.

The first half summarises theories and research. It reviews four sets of theoretical and empirical literature: on the development of social policies and welfare states in the 'West', in particular in Europe; on applying these theories to the developing world; and in a parallel way literature on the emergence of tax and revenue systems in the West and on the relevance of these frameworks and findings to the South. It notes parallels and differences in the findings on fiscal states and welfare states, and the more striking differences between the North and the South.

In the second part we develop a novel model of welfare regimes and demonstrate its utility as a framework for analysing social policy in the developing world. Subsequent sections then operationalise this framework using data for 2000 and introduce the methods of cluster analysis. We present a global map of welfare regimes together with supporting data and analysis; introduce revenue sources and map their cross-national patterns again using cluster analysis; and finally present our findings on the relationship between welfare regimes and state revenue structures. It should be stressed that this empirical analysis relates to the year 2000 and thus takes no account of the quite extensive developments in social programmes in some countries, such as Korea, Chile and China, over the last decade.

The conclusion asks, is there a relationship between specific revenue structures, regime types and welfare outcomes across the global South? It also adds qualifications and cautions about interpreting this type of analysis.

I. THE DETERMINANTS OF WELFARE AND REVENUE SYSTEMS: LITERATURE ON THE DEVELOPED AND THE DEVELOPING WORLD

In this part we review existing literature on the emergence of tax and welfare regimes in the 'West' or OECD world and consider their applicability to the developing world. In practice this means reviewing four relatively distinct sets of research on:

- the development of social policy systems in the OECD,
- the development of tax systems in the OECD,
- the emergence of social policies in the developing world,
- and the emergence of tax and revenue systems in the developing world.

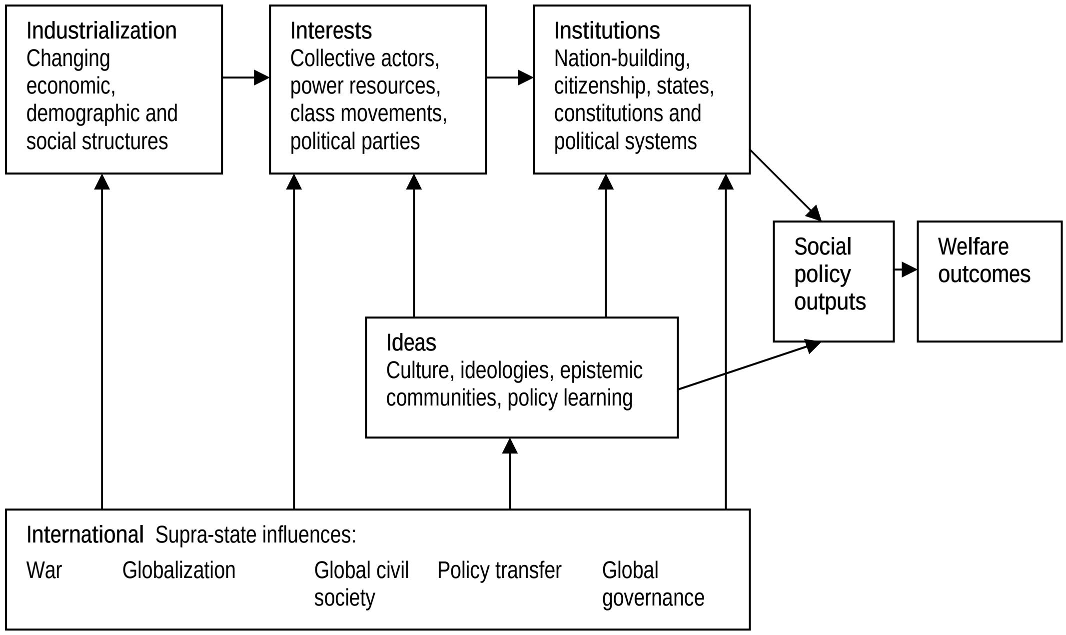
To do this we draw on two recent synthetic works. Gough (2008) reviews theories of Western welfare states and considers their relevance or otherwise for understanding social policies in the developing world (see also Gough and Therborn 2010). Braütigam, Fjeldstad and Moore (2008) similarly review theories of taxation and state-building in the West and consider their implications for understanding tax and revenue policies in developing countries.

1.1 Determinants of welfare states in the West

Gough (2008) presents a model of policy making which identifies five determinants of social policy. These are labeled the "five I's": Industrialization, Interests, Institutions, Ideas/Ideologies, and International Influences. A simple model of the relationship between these determinants and social policy 'outputs' is portrayed in Figure 1.

The following draws on a long history of case study and comparative research into social programmes across the OECD world, which is briefly summarized below (see Gough 2008 for detailed arguments and citations).

Figure 1. A Simple Model of Social Policy Making



Source: Gough 2008: 44

i) ***Industrialization and other macro-social changes***

In the 1950s and 1960s, the dominant school identified social policy as a consequence or correlate of industrialization. The dependent variable was public social expenditure as a share of GDP and the relationship was demonstrated in time series and cross-sectional analysis. It was generally agreed that "economic growth and its demographic and bureaucratic outcomes are the root causes of the general emergence of the welfare state" (Wilensky 1975:xiii). The bases of European welfare state development were two: new social challenges and new resources to meet them. Industrial capitalism produced both.

The explanations of this relationship vary. Some argued that as societies develop, the decline of traditional forms of provision "calls forth" new public bodies and responsibilities. Polanyi in *The Great Transformation* writes of the "societal responses" to social upheavals brought about by the "disembedding" of labor markets from prior social relations. Industrial capitalism tore apart the social patterns of minimal protection of the subsistence family, the village, and the guilds, and it brought together large numbers of men and women outside traditional tutelage, in factories and new cities, creating and incessantly increasing the challenges of social disintegration and of social protest. Others identify the demographic transition that accompanies economic development and transformation as a prime mover, requiring public responses to growing groups like the elderly or small families. All these theories predict growing public social expenditures and converging social programmes in industrial societies.

ii) ***Interests: collective actors, power resources, democracy and parties***

A second set of explanations emerged in the 1970s moving beyond macro-social changes to prioritize the collective organization and powers of major social actors, notably social classes. In the new societies of industrial capitalism two powerful, opposite *interests* converged in generating public social policies. There was the interest of the industrial proletariat in at least some minimally adequate housing and social amenities in the new industrial cities, and in acquiring some kind of security in cases of injury, sickness, unemployment, old age. That interest was soon organized, in trade unions, mutual aid societies and labour-based parties. On the other, there was the interest of political elites in social order and the quality of the population.

A recognition of the role of class-based interests is a feature of the "social democratic" and the "power resources" or "democratic class struggle" models of social policy (Korpi 1983). In an original study of the cross-national policy perspectives of labour and business interests in 1881 and 1981, Therborn (1986) found (not surprisingly perhaps) the labour and trades union movement advocating greater state economic interventions, full employment policies, universal and extensive social policies and greater fiscal redistribution and economic equality. Business organizations favored incentives to growth, private provision plus low coverage of social benefits, and low redistribution. The hypothesis was that the distribution of power resources between the main social classes of capitalist society determined the extent, range and redistributive effects of economic and social policies. These interest-based theories have been corroborated in numerous studies (Stiller and van Kersbergen 2005). The upshot is that "class struggles matter" and "politics matter". It was not so much the industrialization and modernization of Europe and the West that generated welfare states, but the way this was reflected in class cleavages, class organizations within civil society, their respective powers, their economic and social mobilization, and later, their parliamentary representation. A crucial factor has been the emergence of ideologically-based parties pursuing a class-based program of reform, in place of clientelist or personalized parties.

Nevertheless, the power resources approach could not explain the early introduction of social policies by non-class-based parties, or the subsequent emergence of strong but different welfare systems in countries with relatively weak unions and social democratic parties, but strong Christian Democrat parties. This complexity was combined in Esping-Andersen's (1990) influential work on welfare state regimes, which identified not two but three worlds of "welfare capitalism": liberal, social democratic and conservative or Christian democratic.

iii) ***Institutions: states, constitutions and political systems***

A third group of theories claim that political *institutions* mediate the impact of societal interests and/or interpret the welfare state as a 'final stage' of state building. Institutions turned challenges, resources, and interests into consolidated, self-reproducing realities. The welfare state is part of a longer-term process by which power is accumulated in