Are OECD Policy Recommendations for Public Sector Reform Biased against Welfare States? Evidence from a New Database

Andreas Bergh, Margareta Dackehag and Martin Rode

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Research Institute of Industrial Economics
P.O. Box 55665
SE-102 15 Stockholm, Sweden
info@ifn.se
www.ifn.se

Are OECD policy recommendations for public sector reform biased against welfare states? Evidence from a new database

Andreas Bergh, Lund University, BOX 7082, 220 07 Lund, Sweden

Tel: +46 46 2224643 andreas.bergh@nek.lu.se

Margareta Dackehag, Lund University, BOX 7082, 220 07 Lund, Sweden

Tel: +46 46 2228680 margareta.dackehag@nek.lu.se

Martin Rode*, Universidad de Navarra, Departamento de Economía, 31009 Pamplona, Spain

Tel: +34 948 425 600 martinrode@unav.es

Abstract Policy advice by the OECD has long been at the heart of academic debates on welfare state reform, with frequent claims questioning the ideological orientation of recommendations. This paper constructs an indicator of perceived reform need for 23 countries, quantifying the policy advice contained in the OECD Economic Surveys around 1985, 1995, and 2005. These recommendations describe a policy consensus that is based on competition, work incentives, monetary reform, fiscal discipline, and labor market reform. Empirically, *perceived need for reform* is well explained by preceding levels of economic freedom. In particular, countries with more government intervention, lower property rights protection, and more regulation are perceived to have a bigger reform need. In turn, perceived reform need has no explanatory power for subsequent changes in social expenditure and welfare state entitlements. Only in countries with right wing governments, perceived reform need might be followed by marginal reductions in welfare state entitlements, but definitely not in social expenditure.

Keywords *Welfare states, reform, OECD, economic institutions*

JEL codes H53 · P11

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* Corresponding author

1. Introduction

The policy advice provided by the OECD has long been at the heart of academic debates on welfare state reform in developed countries. Ever since the end of the Cold War, there are recurring discussions on the general usefulness of the organization’s economic policy guidance to its member states, as well as the ideological orientation contained in the corresponding publications. Some argue that OECD’s recommendations are strongly influenced by “neo-liberal” thinking and have an ideological content (Grinvalds 2010, Bradley and Stephens 2007), while others argue that the advice given is balanced and not linked to any particular ideological policy standpoint (Deacon and Kaasch 2008, Mahon 2009).

Strikingly, there is very little analysis of the actual advice given by the OECD, or other intergovernmental organizations like the IMF, to its member countries and (to our knowledge) there is no quantitative analysis at all. Some interesting qualitative analysis appear in Armingeon and Beyeler (2008), where fourteen OECD countries are analyzed by national experts, finding very little evidence that the OECD is a powerful driver of welfare state reforms. The current example of Greece shows how reform recommendations from intergovernmental organizations, that are perceived by large parts of the domestic electorate to be ideologically biased, can potentially undermine an otherwise necessary reform process. Therefore, an empirical analysis of what is contained in the OECD’s advice to member states, and how this advice has influenced welfare state restructuring, is critical for an evaluation of the role played by these organizations in the formulation of domestic economic policy.

To assess the nature and impact of OECD recommendations, this paper introduces a new self-compiled indicator based on the OECD Economic Surveys. These in-depth analyses of member state’s economic performance are regularly published, attempting to give crucial and relevant guidance to every member state, as to what economic policy reforms are perceived to be necessary at the moment. Our indicator quantifies each of these OECD policy recommendations in a number of different areas. The resulting database shows the *perceived reform need* in 12 different policy areas for 24 OECD-countries at three different points in time: The mid-80s, the mid-90s and the mid-00s. No such database exists until now, making it a unique tool for empirical studies of the reform advice given by the OECD.

Through both qualitative and quantitative analysis of the data, we find that reforms recommended by the OECD represent a mainstream economic reform agenda, which is highly correlated with the well-known Economic Freedom of the World index by Gwartney et al. (2015). Especially the index dimensions related to government intervention in the economy, property rights security, and economic regulations are found to be highly correlated with OECDs reform advice. Neither comparatively higher welfare state entitlements, nor higher social expenditures seem to play any role at all for receiving more reform advice from the OECD. We also document some variation over time in topics discussed in the reports: The interest in fiscal discipline and monetary reform has been constantly high, the interest in privatization spiked in the 1990s and the interest in wage formation has been declining since the 1980s. Furthermore, we find that perceived reform need has no explanatory power for subsequent changes in social expenditure. In countries with a right wing government that also received more reform advice from the OECD, there are however slightly more subsequent reductions in welfare state entitlements.

The remaining paper is structured as follows: Section 2 describes the content and construction of the database. Section 3 descriptively analyzes OECD policy recommendations and their possible effects for the welfare state. Section 4 empirically examines the determinants of perceived reform need, and how perceived reform need correlates with subsequent changes in welfare state generosity. Section 5 concludes.

2. The OECD reform database

For each of its member countries, the OECD publishes a so-called Economic Survey every 1½-2 years. According to the organization, the surveys are supposed to identify “the main economic challenges faced by the country and analyse policy options to meet them."[2] They contain descriptions of the economic situation in each country, as well as policy advice which at least at first glance appears to be based on standard economic theory.

To empirically capture the OECD's description of the current economic situation and suggested reforms, we have compiled a database containing the *perceived need of reform* at the time around 1985, 1995 and 2005 for 24 member countries. These are all the founding members and those that joined the organization shortly after in the 1960's. For reasons of coverage, no countries with membership from 1990 and onwards, are included in the dataset.[3] Based on the reform advice given in the surveys, patterns of similar recommendations are identified in the reports. In total, 12 different types of policy reforms can be distinguished, which we have grouped into five broad policy areas. These are all specified in Table 1 and the broad policy areas refer to competition, work incentives, monetary reform, fiscal discipline, and labor market reforms. It bears emphasizing that the twelve reform types and the five areas of reform need are not imposed by us. Rather, the aim has been to order the existing advice neutrally into categories that we have given what we claim to be descriptively correct labels.

The resulting database is publicly available to anyone interested in the quantification procedure and the resulting country scores.[4] The database contains the exact formulations used by the OECD, the score that we have assigned to every type of reform, and shows the aggregation procedure into a country score. This process is further described below. In total, we have graded policy recommendations for more than 200 OECD reports to create the database.

The quantitative part of the database classifies the relevant phrases in the surveys according to three degrees of perceived reform need:

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[2] Quoted from http://www.oecd.org/eco/surveys.

[3] OECD Economic Surveys are available electronically from the late 90s, making surveys covering the year of 2005 and/or years in vicinity of the year 2005 easily accessible. For surveys published earlier, the database relies on printed publications. Although surveys from one year before and one year after e.g. 1985 are preferable, there is some variation across the countries with regard to the number of years covered. This is all made transparent in the corresponding database.

[4] The database is available at http://tinyurl.com/pdrf4hy .

0. Little or no need of reform

1. Some need of reform

2. Big need of reform

A reform need that is coded as “2” characterizes a policy situation, which is perceived to be quite serious: the OECD generally describes such instances with formulations like “urgent” or “considerable” need for reform, “ample” scope for reform, and so forth. The assessment can refer to a specific policy reform or to the accumulated need over a number of different reform types. If the second case applies, we assign the code “2” to all the policy reform types involved.

Table 1 Twelve policy reforms in five areas

A. Competition
A1. Increase trade and competition (e.g. the removal of trade barriers and capital regulation)
A2. Introduce freedom of choice in the public sector (e.g. vouchers)
A3. Use topping up and user fees to combine public and private financing
A4. Privatization of state-owned enterprise
B. Work incentives
B1. Lower taxation of labor (e.g. lowering marginal tax rates, broadening the tax base)
B2. Actuarial social insurance reforms: Strengthening the insurance aspects of pension systems, sickness benefits, unemployment insurance et cetera.
B3. Less generous social insurance (e.g. lowering replacement rates, establishing clear time limits for benefits durations)
B4. Increased conditionality of benefits (e.g. conditioning entitlements on active job search or participation in labor market programs)
C. Monetary reform
D. Fiscal discipline
E. Labor market reform
E1. Labor market flexibility (e.g. reforming employment protection laws)
E2. Reforming wage formation process towards greater wage flexibility and lower inflationary pressure.

A reform need that is coded as “1” characterizes a situation where the corresponding government has made some effort to undertake a certain policy reform, but where there is still quite some room for improvement according to the OECD. To go from a situation coded as “2” in the database to a “1”, we thus require that the government in question recognizes the need for reform and takes some type of measure to alleviate the problems identified in the reports. The choice to code reform need as 0, 1, or 2 was made because only two categories would mean losing easily coded information, while having more categories would introduce hard to solve classification problems. The coding is done so that the distance from 1 to 2 is roughly the same as from 0 to 1.

Due to the fact that a policy reform area may consist of several elements, the average progress over all related reform types was used for our evaluation. Therefore, a reform state that is assigned e.g. a "1" may refer to a situation where the overall progress in that area is limited. Similarly, the code could also describe a situation where reform measures are taken by the government with regard to some elements, while other problematic aspects are left unresolved (e.g. reform need in labor market flexibility is judged to be of degree "1" because programs have been made more efficient in activating the unemployed, while there is considerable scope for increasing the efficiency of the placement services). Both possibilities are coded in the same manner.

The code "0" characterizes a policy situation where a "key reform" has already taken place or where "considerable progress" has been made concerning a certain reform type. Although additional improvements may remain, the reform process is going in the right direction according to the OECD evaluation. Alternatively, the code refers to a situation, where the number of identified reform needs has substantially decreased, as a result of good performance in those same policy types. Therefore, a member country with OECD average performance or better also receives a "0" (e.g. the reform need in terms of openness, is assessed to be small, i.e. of degree "0", as the OECD observes a progression towards a more pro-competition stance but at a pace not more rapid than elsewhere).

Regarding the construction of the individual country values, the database quantifies the perceived reform need for 24 countries at three points in time: around 1985, 1995 and 2005 (see Figure 1). Country values for 1985 generally reflect the average of up to four different reports between 1982/83 and 1986/87. Values for 1995 and 2005 are constructed likewise. Scores are assigned to each of the twelve policy types, according to the perceived OECD reform need that a country presents in this specific area, employing the quantification criteria described above. The database contains all comments from the OECD Economic Surveys that we consider to be relevant for the quantitative assessment of reform need (i.e. “2,” “1” or “0”). Final country scores for perceived reform need are obtained by simply averaging across all five policy areas. For further information on each country and time period, we refer the reader to the actual database.[5]

During the data collection, we noted a number of potentially distortive issues, which we would like to address in the following paragraphs. These issues do not influence the objectivity or quality of our data, but for reasons of scientific transparency and completeness, the user should be aware of their existence.

First, the fiscal policy performance of European member countries is often related to the Maastricht stability criteria, which were established in the early 90s. When the OECD considers these criteria to be within reach and observes on-going consolidation efforts, we classify the fiscal reform need as small. For non-European members, there are no such criteria to which we can directly compare their performance. Nevertheless, we have not been able to identify any systematic discrepancy between European and non-European members regarding the perceived reform need in fiscal policy.

Second, the ambition of this database is to classify the initial reform need. Due to the fact that we take the average of a certain time period for each country, it is practically impossible not to include some time-varying elements as well. When the OECD identifies a reform need in a certain policy area for the first time, the coding takes into account the build-up of problems prior to the year of study and reflects the success of the reform measures taken in the review of next year’s performance. For example, if the budget deficit has increased sharply around 1980 and the government takes corrective steps around 1982/1983, the assessment of fiscal policy in 1982 is a “2,” while the performance in 1983 receives a “1”. Nonetheless,

[5] All users of the data are welcome to try different scales or aggregation procedures, if they wish to do so. In any case, estimation results with the overall indicator are highly insensitive to the type of index aggregation used.

we regard this to be a very minor problem of the database, as most of this intra-period variation is very small, compared to the variation between different time periods.

Third, each time period appears to have a unique character in terms of main problems identified and described. These reflect the existence of scientific trends, which are totally exogenous to our influence or coding scheme. Generally, it seems to go from very strong focus on monetary and fiscal policies in the 1980's, to a broader spectrum of issues in the 1990's and 2000's that includes various structural reforms. In addition, the OECD sometimes "retroactively" identifies a reform need. Policy areas that were not mentioned in the previous survey are then described with formulations like "the changes recently made to the function of public placement services will probably enhance efficiency." In those cases, we simply classify the situation prior to the undertaken measure as one with some reform need (i.e. "1"). Overall, surveys from the 1980's seem to focus on facts and contain little evaluation. Starting in the 1990's and particularly the 2000's, surveys take more of an observing stance, using strong words and formulations to make more frequent policy recommendations. This latter observation might actually point to an increased OECD involvement in the reform process of member states, even though this is not necessarily linked to any particular ideological standpoint.

Fourth, it is important to note that the database captures reform need as perceived by the OECD. To some extent, the judgements are also a product of negotiations between the OECD and the individual member country. The database should thus not be seen as a description of a completely objective reform need, but might rather reflect internal political power to some degree. For example, a situation with serious need of reform in the mid-1980s may not be considered equally urgent when comparing it to the inflation levels, budget deficits, etc. of the mid-1990s. In many cases, a country given a "2" in both situations in reality experienced a deteriorating situation. To some degree, this is a political bias in the data, which we can obviously do nothing about. It is the result of a political economy game that is played between the OECD experts and the representatives of each individual member state long before reports are made publicly available. In that sense, it will be highly interesting to see, how OECD recommendations compare to other economic policy databases that do not present such a negotiation bias. This will be analyzed in section 4.

3. Qualitative analysis: A consensus for or against welfare states?

As mentioned in the introduction, the policy advice in OECD Economic Surveys has been described as influenced by "neo-liberal" thinking (Grinvalds 2010, Bradley and Stephens 2007), and Cammack (2009:24) speaks of an "OECD/EU program for restoring the hegemony of capital over labor in the developed world." In contrast, Deacon and Kaasch (2008) argue that the OECD is not a 'neoliberal stalking horse' but rather is concerned with balancing equity and market efficiency, and Mahon (2009:183) carefully notes that "[f]or some [OECD] has used its 'soft powers' to contribute to the construction of a neoliberal world order, however neoliberal solutions are not the only ones it has to offer, especially in the area of social policy".[6]

At face value, reforms in the five policy areas (competition, work incentives, monetary reform, fiscal discipline and labor market reform) typically involve a substantial restructuring of welfare states, but not necessarily welfare state retrenchment or lower total tax revenue. Area A contains reforms aimed at increasing competition in several ways, none of which necessarily requires welfare state retrenchment. Trade-openness can increase the level of competition in the economy without demanding welfare state cutbacks.[7] In fact, some scholars have noted a positive correlation between welfare state size and economic openness, suggesting that the two complement each other. For example, Iversen (2005) argues that international trade allows countries with extensive welfare states to specialize in high value-added services.

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[6] Note that we use the word "neoliberal" as it is often used in the press, specifying any reform that is perceived to be directed against the welfare state, despite the fact that this has nothing to do with the original meaning or the word. In fact, the term neoliberalism is nowadays applied so broadly that it is hard to actually deduce any concrete policy package that it clearly identifies, making it essentially useless in academic debate (i.e. Boas and Gans-Morse 2009).

[7] Bergh and Nilsson (2010) find that trade openness is related to income inequality, but this is not necessarily caused by welfare state cutbacks.

Tax-financing of welfare service can be combined with competition and freedom of choice by the use of voucher financing, as described for example by Bartlett et al. (1998). The use of topping up and user fees to combine public and private financing is, at least in the short run, compatible with extensive welfare state arrangements. In the long run, it may pave the way for cutbacks following the "Leninist strategy" described by Butler and Germanis (1983), but it is also possible that these reforms increase welfare state support among high income earners, as suggested by Bergh (2008). Finally, publicly owned corporations that are unimportant for the provision of welfare services can be privatized, thereby increasing competition without welfare state retrenchment.

Area B contains reforms to increase work incentives. While lower taxation of labor might lead to lower tax revenue and thus to decreased welfare state generosity, it is possible to lower tax rates without decreasing tax revenue if the tax system is made more efficient. Indeed, the trend in OECD countries is to decrease marginal taxes on labor, but this has not led to corresponding decreases of average tax revenue, as demonstrated by for example Curzon-Price (2008). Many high tax countries have implemented reforms with the specific goal of increasing efficiency and work incentives without decreasing tax revenue – see Aarbu and Thoresen (1997) on the case of Norway, and Agell et al. (1996) on the case of Sweden. Furthermore, generous social insurance schemes and welfare benefits are often assumed to decrease work incentives, but designs such as negative income tax schemes, so-called Bismarckian benefits, set as proportions of previous incomes and benefits with clear time limits may be generous without large negative effects on work incentives, as described for example by Lindert (2004).

Note further that between B3 (decreased generosity) and B4 (increased conditionality) there is some degree of substitutability. If replacement rates are lowered, there is less need for conditionality. Similarly, increased conditionality might allow for relatively more generous benefit levels. Nevertheless, if countries choose to both lower benefits and increase conditionality, this is clearly a case of welfare state retrenchment. The latter situation would pretty much describe the current state of affairs in many Southern European member countries. Notwithstanding, these highly unpopular measures were often not recommended by the OECD, but rather by the IMF and the European Commission (Wölfl and Mora Sanguinetti 2012).

Area C, monetary reform, has no obvious implications for welfare state size. The same goes for area D, fiscal discipline: While big welfare states often under balance their budgets more in economic downturns, tax revenue also increase more rapidly when the economy is booming. This is a result both of the taxation of profits (that are higher during booms), and also as a result of progressive income taxation. Viewed over an entire business cycle, there is no reason to expect generous welfare states to be incompatible with fiscal discipline.[8]

Finally, when the OECD stresses the need for labor market reforms, area E, the target is often the Nordic welfare states. But despite the historical correlation between welfare state generosity and labor market regulations, there is little if anything that prevents countries from changing their level of employment protection (such as e.g. the *last hired, first fired rule*). In fact, the case of Denmark is often used as an example of a Nordic welfare state that implemented most of what OECD suggested in terms of labor market reforms, resulting in what is sometimes called *flexicurity*, the combination of a highly flexible labor market and relatively generous insurance schemes for the unemployed.[9] Another example is the case of Greece, where the OECD actually recommended higher unemployment insurance to avoid the trend that people preferred early retirement to remaining as unemployed in the labor force.[10] Of course, this is clearly not what has been implemented in the current reform process in Greece, as the informed reader will note. This fact vividly highlights that recommendations, however good or bad they may be, are just one intervening element of many in the complex political-economy process of a welfare state reform.

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[8] In fact, in the wake of the 2008 global financial crisis, problems with fiscal discipline did not systematically increase in countries with high taxes and extensive welfare states, but rather the opposite.
[9] See, for example, Andersen and Svarer (2007).
[10] See the OECD reform database for Greece, mid-1990s.

The debate on a potential ideological bias in the recommendations seemingly suggests that any such bias is constant over time. Using the database, it is easy to check the recommendations for trends in the interest of different types of reforms. Table 2 describes how the interest in various reform topics have changed over time. Note that interest indicates only that the topic is discussed, and is thus independent of the perceived intensity of reform need.

Table 2 Trends in OECD interest for different types of reforms[11]

Competition	1980s	1990s	2000s
Openess	58%	74%	75%
Vouchers etc.	2%	23%	31%
Topping up etc.	2%	12%	12%
Privatization	17%	66%	47%
Work incentives			
Labor taxation	62%	68%	72%
Actuarial soc ins	12%	44%	61%
Less generous soc ins	23%	70%	66%
Conditionality benefits	6%	53%	55%
Monetary reform	94%	96%	96%
Fiscal discipline	98%	100%	100%
Labor market reform			
Labour market flexibility	34%	76%	61%
Wage formation	66%	71%	40%

From Table 2 it is clear that some topics are almost always discussed, namely fiscal discipline and monetary reform. The interest in other topics varies substantially over time. Most strikingly, the interest in privatization spiked in the 1990s, but then declined somewhat again. Labor market flexibility has a similar, but less extreme, pattern. The interest in wage formation has been declining since the 1980s, and at the same time the interest in conditionality and actuarial social insurance reforms has been increasing.

Summing up, an examination of the advice given in the Economic Surveys does not support the idea of a neo-liberal policy consensus hostile towards generous welfare states: In all areas, it is at least theoretically possible to implement the OECD

[11] The interpretation is that a percentage of 100 means that the topic is discussed in all reports for all countries. Interest indicates only that the topic is discussed, and is thus independent of intensity of reform need.

recommendations without substantial cutbacks of the welfare state. Indeed, the reforms undertaken in the Scandinavian welfare states since the early 1990's (cf. Bergh and Erlingsson 2009) are a good example of how OECD recommendations balance goals of market efficiency and equity.

4. Quantitative analysis

In this section, we first analyze what explains perceived reform need. Is it influenced by short term performance, overall economic development, or does it rather shed some light on the institutional nature of member countries? Theoretically, a number of issues might be reflected in the Economic Surveys, such as GDP level, unemployment, preceding growth performance, or economic and political institutions.

In a second part, we also analyze the development of welfare state generosity after the OECD recommendations are given. While the qualitative analysis suggested that countries can follow most advice without welfare state cutbacks, it may still be the case that countries with high perceived reform need respond by decreasing welfare state generosity.

4.1 Data and methodology

Table 3 contains an overview of the data used, showing sources and basic statistics for all variables employed. Of these, OECD reform need has already been discussed extensively in the previous sections and a number of standard economic control variables, such as the logarithm of GDP per capita, or the unemployment rate, don't require any further explanation. All other variables of relevance for our estimations are further described below.

In order to capture welfare state generosity, we employ two different indicators: First, social expenditure as a share of GDP, taken from OECD's Social Expenditure Database. This well-known measure captures the combined effect of policy intentions (i.e. rules) and other factors that influence outcomes. It is therefore an outcome measure, even though it clearly doesn't capture the efficiency of spending. Second, the Comparative Welfare Entitlements Dataset (CWED), which contains information about the structure and generosity of social insurance benefits in 33 countries around the world. We include this measure, because it is designed to capture the generosity of rules, not relative expenditure. It is therefore only influenced by other factors (such as GDP) to the extent that these influence the rules regarding welfare policy. This indicator was first introduced for 18 countries by Allan and Scruggs (2004), and was updated in 2014 to now include 33 countries over the period from 1961 to 2010.[12] The combined score contains information on replacement rates, duration, qualification time, waiting time and coverage for unemployment and sick pay insurance, and public pensions.

To capture political and economic institutions, we employ four different indicators: First, the Political Constraints (Polcon) Index by Henisz (2000), which identifies the underlying structures of political systems and their ability to support credible policy commitments. The measure is strongly correlated with the Polity "Executive Constraint" index, measuring the political constraints on executives in the process of policymaking, based on a one-dimensional spatial model of interaction between the different chambers of the legislative, the judiciary, and sub-federal institutions. The final index ranges from zero to one, with zero representing the lowest level of constraint. The expected effect of constraints on reform need is far from obvious: Fewer constraints might facilitate reforms, but may also lead to situations where reforms are more needed, see Rode and Gwartney (2012) for a discussion on how economic and political institutions are related.

Second, we employ a measure of government ideology by Bjørnskov and Potrafke (2011), based on information from the Polcon database by Henisz (2000). Here, left wing parties in government are assigned a value of -1, or -0.5 and right wing parties in government a 0.5 or 1. Pure center parties in government and so called "great coalitions" are coded as 0. In recent years, numerous studies have shown that government ideology influences growth and economic institutions (cf. Bjørnskov 2005, Potrafke 2010, Faccini and Melki 2014). Generally, findings support that

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[12] Scruggs, Lyle, Detlef Jahn and Kati Kuitto. 2014. "Comparative Welfare Entitlements Dataset 2. Version 2014-03." University of Connecticut & University of Greifswald. Available for download at http://cwed2.org/
For an analysis of how this indicator relates to the Social Citizenship Indicator Program (SCIP), see Scruggs (2013).

right wing governments are more inclined to pursue pro-growth policies. As a consequence, we might expect that OECD countries with more conservative governments also receive fewer reform recommendations. One would also expect this to be the case, if the OECD as an organization really has a “neoliberal bias”.

Third, we use an indicator of political fractionalization in parliament, which is also taken from Bjørnskov and Potrafke (2011). This measure is based on an inverted Herfindahl index of all parties represented in the national parliament, ranging from zero to one. Zero represents total concentration of the legislature, while one represents maximal fractionalization. It might be expected that fractionalization of the legislature influences the economic reform process via the formation of parliamentary consensus on reform issues. A priori it is unclear though, if we should expect more fractionalization to positively or negatively associated with perceived reform need (cf. Pitlik and Wirth 2003).

Finally, we include the Economic Freedom of the World (EFW) index by Gwartney et al. (2015). This index is published annually by the Canadian Fraser Institute, and is based on 43 specific components, all measured on a zero to ten scale, capturing the degree to which the economic institutions and policies of a country correspond to free market principles. Zero represents the least free and ten the most free. The index is divided into five major areas: 1 Size of government: Expenditure, taxes, and enterprises, 2 Legal structure and security of property rights, 3 Access to sound money, 4 Freedom to trade internationally, and 5 Regulation of credit, labor, and business. The summary rating for each country is calculated by simply taking the mean of the ratings in each of the five areas. The EFW compound index and underlying areas have been used extensively by economic researchers in recent years (e.g. Berggren 2003, Berggren and Jordahl 2005, Justensen 2008). Generally, we would expect that countries with more market oriented institutions also have a lower reform need, as identified by the OECD.

Table 3 Variables, sources, and descriptive statistics

Variable	Unit / Range	Mean 1980's	SD 1980's	Mean 1990's	SD 1990's	Mean 2000's	SD 2000's	Mean overall	SD overall	Source
OECD Reform	0–2	1,2	0,42	0,78	0,33	0,44	0,27	0,79	0,45	Author compilation
Log GDP p.c.	PPP US$ (const. prices)	9,8	0,33	10,1	0,32	10,3	0,33	10,1	0,37	OECD Statistics
Unemployment	in % of total labor force	4,9	3,0	6,3	3,8	6,0	3,0	5,8	3,3	OECD Statistics
Log av. Inflation	% change of CPI	-2,5	0,79	-3,5	0,93	-3,7	0,70	-3,2	0,95	OECD Statistics
Social Expenditure	in % of total GDP	16,9	5,9	19,0	5,8	20,2	5,2	18,7	5,7	OECD Statistics
Comparative Welfare Entitlements (CWED)	0-50	31,0	7,6	31,4	7,3	31,8	6,5	31,4	7,0	Scruggs et al. (2014)
Gini coefficients	0-100	28,5	6,1	27,7	5,3	29,5	5,5	28,5	5,6	Solt (2014)
Elderly share (65+)	in % of total working pop.	18,8	3,8	21,1	3,6	22,7	4,7	20,9	4,3	OECD Statistics
Political Constraints	0–1	0,73	0,18	0,76	0,13	0,78	0,10	0,75	0,14	Henisz (2000)
Government Ideology	-1–1	-0,42	0,77	0,26	0,86	-0,19	0,74	0,01	0,80	Bjørnskov and Potrafke (2011)
Fractionalization	0–1	0,66	0,12	0,67	0,11	0,70	0,10	0,68	0,11	Bjørnskov and Potrafke (2011)
Economic Freedom (EFW)	0–10	6,4	0,97	7,2	0,75	7,8	0,63	7,2	0,97	Gwartney et al. (2015)

Government Size (EFW A1)	0–10	4,3	1,1	4,8	1,2	5,0	1,4	4,7	1,3	Gwartney et al. (2015)
Legal Quality (EFW A2)	0–10	7,2	0,81	7,9	0,85	8,6	1,1	7,9	1,1	Gwartney et al. (2015)
Sound Money (EFW A3)	0–10	7,2	2,2	8,6	1,6	9,3	1,2	8,3	1,9	Gwartney et al. (2015)
Trade Freedom (EFW A4)	0–10	7,4	1,4	8,2	0,98	9,0	0,48	8,2	1,2	Gwartney et al. (2015)
Regulation (EFW A5)	0–10	6,2	1,1	6,7	1,1	7,2	0,79	6,7	1,1	Gwartney et al. (2015)

As mentioned above, the database quantifies perceived reform need for 24 countries around 1985, 1995, and 2005. For our estimations, this gives us a balanced panel dataset with 23 cross-sectional observations and three time periods for analysis. We exclude Turkey in the empirical analysis as it is always a clear outlier.[13] In Figure 1 the information contained in the database is visualized in a horizontal bar graph, classifying reform need by OECD member country and decade. It can be seen that there is quite some variation across countries and time periods, with the Southern European member countries generally showing a higher reform need than most North- and Central European members. This observation reflects common intuition on the issue. It can also be seen that the perceived reform need is highest in the mid-1980's, when most countries still suffered from the second oil crisis of 1979. Perceived reform need is somewhat lower for the 1990's, when many countries nonetheless experience an economic crisis in the wake of the Cold War ending. Perceived reform need then decreased rapidly until the mid-2000's, which obviously reflects the economic expansion phase before the financial crisis of 2008.

Due to the fact that perceived reform need is calculated for the middle of the 1980's, 1990's, and 2000's, we only employ data from the beginning of the corresponding decade for all control variables, when investigating the determinants of OECD reform need. To avoid any direct temporal overlap, data is thus from years 1980, 1990, and 2000. Average GDP growth data is for the ten years preceding.[14] When the focus is on the outcomes of OECD reform recommendations, control variable data is from years 1985, 1995, and 2005 to temporally coincide with the main variable of interest. In addition, variables that measure changes reflect the average growth figures of the following ten years.[15] Estimations with the data are conducted using simple OLS analysis with robust standard errors, as suggested by Arellano (2003). This estimator has specific efficiency properties in small datasets, where more cross-sectional elements are available than time periods. Furthermore, we employ a model that controls for cross-country heterogeneity by introducing a country fixed-effects dummy.

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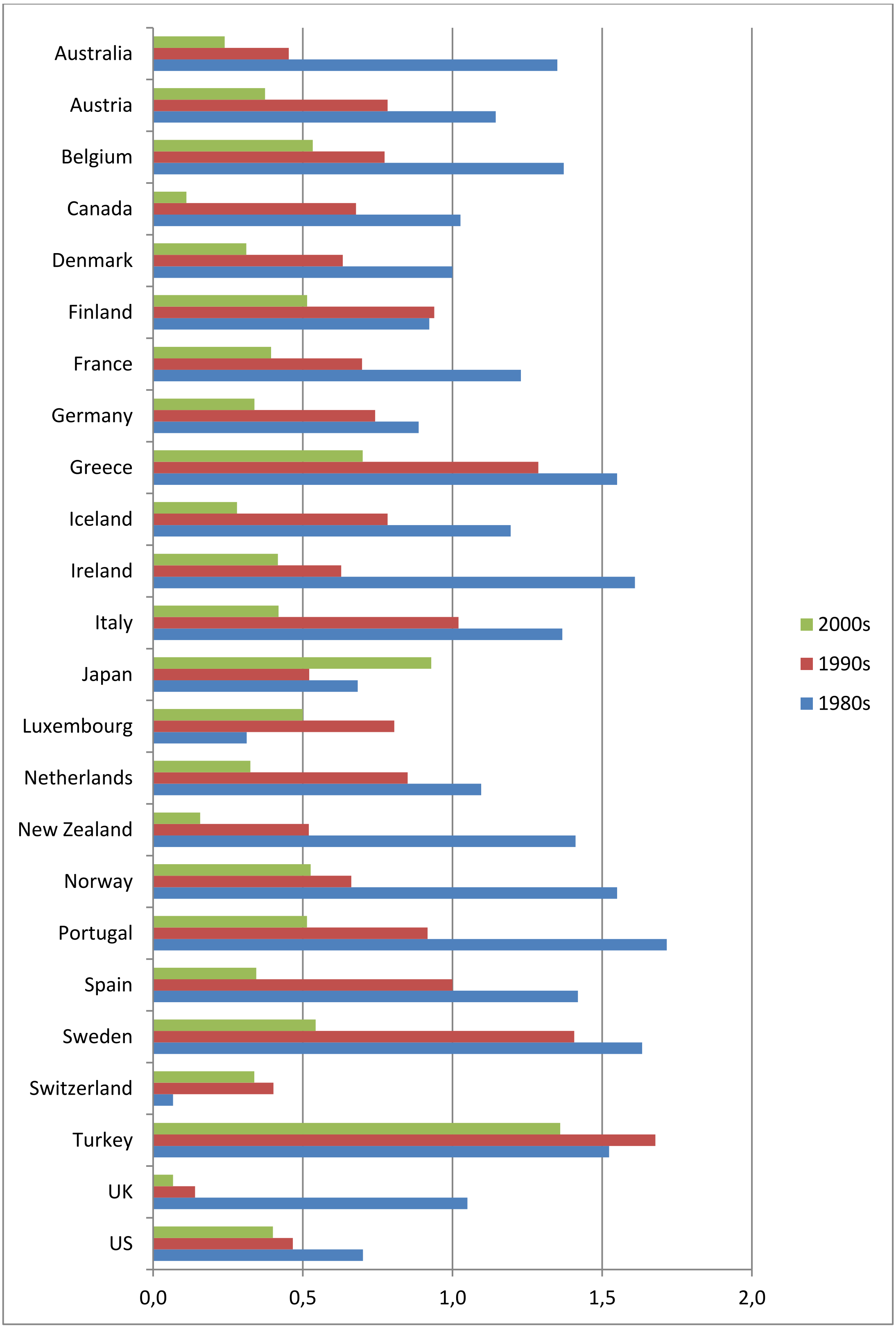
[13] All the important findings are unaffected by the inclusion of Turkey. These are not shown, but available upon request.
[14] In particular, between 1970 -1979, 1980-1989, and 1990-1999;
[15] Between 1985-1994, 1995-2004, and 2005-2013;

Figure 1 OECD reform need by country and decade



4.2 What explains reform need?

The pattern visible in Figure 1 suggests that perceived reform need might simply reflect economic growth, such that countries with lower growth are seen to be in higher need of reform. A similar possibility is that poorer countries are seen to be lagging and thus perceived to have higher need of reform. As mentioned above, OECD recommendations might also pick up political institutions in the sense that less constrained executives, left wing governments, or more fractionalized parliaments are associated with an elevated reform need. Similarly, countries with less market oriented institutions could be perceived by the OECD to have a higher reform need.

Table 4 summarizes the potential determinants, where we test for a number of different possibilities: Equations 1 and 2 employ some basic economic indicators as potential controls for perceived reform need. Both models find that a comparatively high GDP p.c. is significantly associated with a lower perceived reform need, while on the contrary an elevated inflation is significantly correlated with a higher perceived reform need. Therefore, it seems that OECD reform perceptions somewhat reflects per capita income and inflationary episodes. In turn, unemployment is insignificant in both models, while leading economic growth also presents no statistical relevance for receiving more or less reform recommendations in equation 2, despite the fact that both variables present the expected sign. Following the model of partisan political business cycles by Hibbs (1977, 1992), where left-wing parties focus on fighting unemployment and right-wing parties focus on containing inflation, these results indicate that there might actually be somewhat of a conservative (or mainstream) economic bias contained in the OECD recommendations.

Turning to the issue of how social security systems are associated with reform recommendations, we find an insignificant association between both, social expenditure and OECD reform need in equation 3, and comparative welfare state entitlements (CWED) and OECD reform need in equation 4. Thus, OECD recommendations do not seem to reflect variations in social expenditure, nor formal welfare state entitlements. Interestingly, when including Gini coefficients as an additional control variable in both models, the variable shows up as negative and significant in equation 3, but not in equation 4. This would tentatively mean that more inequality is associated with a lower perceived reform need, although the possible underlying reasons for this are multiple.

In contrast, the preceding aggregate level of economic freedom does a very good job of explaining perceived reform need, with high statistical and economic significance (equations 5 to 7). The negative sign on this variable suggests that OECD reform advice does a good job at pointing out the weaknesses in countries economic institutions. Interestingly, all other economic control variables loose statistical significance at the introduction of the overall EFW index in equation 5. We can therefore conclude with some certainty that OECD recommendations do not systematically reflect member countries' overall development level or inequality, but rather its underlying economic institutions that are ultimately responsible for differences in prosperity (cf. de Haan et al. 2006). This finding would also indicate that any political economy bias in the recommendations, resulting from negotiations between the OECD experts and the individual country representatives is relatively small, if it exists at all.[16].

Equations 6 and 7 introduce additional institutional controls: In equation 6, the Polcon variable presents the expected negative sign, but it is insignificant for explaining variations in OECD reform need. Equation 7 introduces the political ideology and fractionalization variables. Here, the Polcon indicator is excluded for collinearity reasons, as all three variables originate from the same source. Contrary to our expectations, government ideology shows a positive sign in equation 7, but it is also insignificant. This means that we find no support for the claim that perceived reform need is significantly related to the political ideology of the government in power, nor that there is any type of systematic ideological favoritism contained in the OECD Economic Surveys. In turn, fractionalization presents a negative and significant relationship with OECD reform need in equation 7, indicating that more fractionalized legislatures receive less reform recommendations. Although perhaps somewhat counterintuitive, maybe this is a

[16] Including the annual budget share of each OECD member country as a measure of internal political power into our regressions, we also find no indications of such a negotiation bias. This result is not shown, but available upon request.

consequence of coalition governments, which are more likely under these circumstances. By logic of interest representation, these regimes have to find an ample consensus when it comes to the formulation of economic reform policy, making radical policy swings relatively less likely than under an unconstrained one-party government (cf. Heniz 2000). An alternative interpretation is that fractionalization and political constraints function as veto points against bad policies. The latter is supported by recent research in Dahl (2014), who finds that veto players and fractionalization exert a constraining effect on changes in the size of government.

Table 4 OECD reform determinants

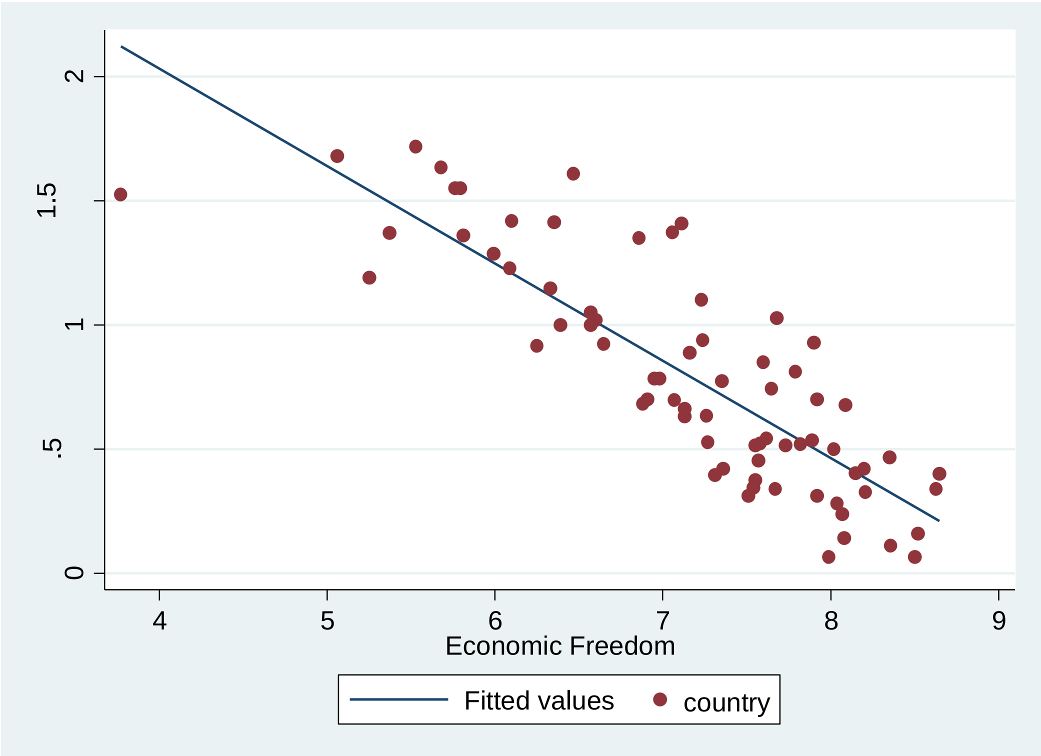
Dep. var.:	**OECD reform**						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Log GDP p.c.	-0,998**	-1,076***	-0,704	-1,271***	-0,030	-0,001	-0,169
	(-2,11)	(-2,81)	(-1,41)	(-6,16)	(-0,08)	(-0,00)	(-0,46)
Unemployment	-0,008	-0,006	-0,014	-0,015	-0,016	-0,014	-0,008
	(-0,41)	(-0,28)	(-0,65)	(-0,71)	(-0,94)	(-0,83)	(-0,54)
Log av. Inflation	0,212**	0,171*	0,166*	0,173***	0,012	0,005	0,044
	(2,11)	(1,89)	(1,94)	(3,16)	(0,15)	(0,07)	(0,54)
Growth ($dGDP_{t-1}$)		5,485					
		(0,71)					
Gini coefficients			-0,060**	-0,029	-0,029	-0,034	-0,031
			(-2,42)	(-1,59)	(-1,44)	(-1,55)	(-1,54)
Social Exp.			-0,020				
			(-0,69)				
Welfare Ent. (CWED)				0,026			
				(1,29)			
Economic Fr. (EFW)					-0,489***	-0,484***	-0,496***
					(-3,70)	(-3,75)	(-4,15)
Pol. Constraints						-1,295	
						(-1,63)	
Gov. Ideology							0,019
							(0,59)
Fractionalization							-1,155*
							(1,89)
N	66	66	65	55	65	65	65
Countries	23	23	23	21	23	23	23
Adj. R^2	0,68	0,69	0,74	0,84	0,83	0,83	0,85

F-statistic	21,8	36,8	25,2	43,3	82,0	80,7	138,4

Note: t-statistics in parenthesis; * significant at 10%; ** significant at 5%; *** significant at 1%;

As shown above in Table 4, the single most important explanatory variable for perceived reform need is the preceding aggregate level of economic freedom. Figure 2 plots the relationship between OECD reform need and the overall economic freedom index, showing also the fitted values to highlight the strong association between both variables. It can be observed that the statistically significant relationship is close to linear and it is obviously not the product of outliers, which is always a danger in small datasets such as this one. Therefore, it seems that OECD reform advice does indeed present a strong economic-institutional focus. Of course, this also means that if someone perceives the EFW index to be loaded with a "neoliberal reason" (cf. Peck 2010), that person will undoubtedly also find this result to be the best proof that the OECD is indeed plagued by a neoliberal bias. As also noted above, there might certainly be a tendency to follow a more conservative economic agenda.

Figure 2 OECD reform need and economic freedom



To further examine the association between economic freedom and OECD reform need, Table 5 employs the EFW areas as control variables for the overall OECD index and its individual composite areas. Equation 1 finds that particularly changes in the size of government (area 1), legal structure and property rights security (area

2), and overall regulation (area 5) explain variations in perceived overall OECD reform need across member countries. It is likely that access to sound money (area 3) and freedom to trade (area 4) present an insignificant association, because all OECD member countries score rather high in this area, when comparing it on an international level.

Regarding the association of the EFW areas with the individual OECD areas, equation 2 shows increased competition to be significantly associated with freedom to trade at the 5% level and with economic regulation at the 1% level. In both cases, the result confirms our expectation, as trade restrictions and economic regulations are primary ways of protecting incumbent firms. Equation 3 shows for increased work incentives to be statistically related to sound and secure property rights at the 5% level. This also makes intuitive sense, because increased work incentives will only be effective, if workers and entrepreneurs are also able to reap the benefits of any additional effort. As might be expected, equation 4 shows for monetary reform to be significantly associated with the access to sound money and the size of government, each at the 1% level, and with freedom to trade at the 10% level. Similarly, fiscal discipline is also significantly related to the size of government in equation 5 (1% level) and, perhaps somewhat more surprising, to the presence of secure property rights. The only real surprise is found in equation 6, which shows that labor market reform is significantly related to secure property rights, but only at the 10% level. Overall, the policy areas of our OECD reform need indicator are therefore empirically confirmed to measure the concepts they intend to capture, which greatly enhances our confidence in them.

Coming back to the issue of social expenditure for perceived reform need, the missing relation between both variables is to some degree mitigated by the negative and significant impact of government size on OECD recommendations in equation 1. Still, this finding highlights that reform advice on public expenditure issues is not taken on the basis of social spending, but rather takes into account other aspects of government expenditure, including tax rates, government consumption, and public enterprises. As discussed earlier, welfare state reforms in these areas do not have to be synonymous with welfare state retrenchment, but can rather enhance its efficiency. In summary, while there is no bias against welfare state spending, countries with bigger public sectors are actually viewed as more problematic by the OECD, confirming the somewhat more conservative economic tendencies described above.

Table 5 The EFW as predictor of OECD reform types

Dep. var.:	OECD overall	Comp. (A)	Work In. (B)	Money (C)	Fiscal (D)	Labor (E)
	(1)	(2)	(3)	(4)	(5)	(6)
Gov. (A1)	-0,134***	-0,051	-0,029	-0,285***	-0,274***	-0,010
	(-3,09)	(-0,61)	(-0,30)	(-3,70)	(-3,06)	(-0,20)
Legal (A2)	-0,133***	-0,021	-0,222**	-0,127	-0,207***	-0,112*
	(-2,83)	(-0,19)	(-2,27)	(-1,66)	(-3,39)	(-1,78)
Money (A3)	-0,056	-0,054	0,014	-0,168***	-0,083	-0,064
	(-1,28)	(-0,55)	(0,21)	(-3,25)	(-1,01)	(1,67)
Trade (A4)	-0,113	-0,227**	-0,081	-0,137*	-0,120	0,054
	(-1,68)	(-2,45)	(0,92)	(-1,71)	(-0,92)	(0,98)
Reg. (A5)	-0,165***	-0,450***	-0,112	-0,053	-0,114	-0,084
	(-2,93)	(-3,40)	(-1,11)	(-0,59)	(-1,35)	(1,16)
N	69	64	68	66	69	66
Countries	23	23	23	22	23	23
Adj. R^2	0,77	0,68	0,34	0,77	0,64	0,32
F-statistic	39,6	27,5	5,8	39,7	20,1	7,4

Note: t-statistics in parenthesis; * significant at 10%; ** significant at 5%; *** significant at 1%

4.3 Are recommendationsassociated with welfare state retrenchment?

Do countries with high perceived reform need behave differently afterwards? Taking an altruist perspective of government, one might expect political leaders and bureaucrats to take up the OECD's recommendations, in order to formulate and implement real economic policy reforms. If one takes an interest perspective of governmental actors instead, it is very unlikely that reform advice will have any real impact at all, as policies are highly constrained by partial interests and path dependent processes at the country level.

To examine the association with social policies, we regress changes in social expenditure (equations 1 to 4) and changes in welfare state generosity (equations 5 to 8) on our indicator of OECD reform need in Table 5. If OECD recommendations are in fact driven by a consensus against welfare states and governments follow its judgements, the corresponding variable for perceived reform need should show a negative and significant association with following changes in social policies. Here, relating recommendation levels to following changes in policies also provides us with an additional indicator against possible reverse causality, even though both variables can still be endogenously determined by a third underlying factor that is unknown to us.

The standard control variables that we introduce into each equation are the following: First, the initial values of social expenditure or welfare state generosity, which we expect to show up as negative. This means that countries with a smaller welfare state will ceteris paribus also increase their social programs more quickly in subsequent periods. Second, the initial level of GDP per capita that we expect to be positive, as richer countries can also afford to create a proportionally bigger welfare state. Third, the share of the population that is over the age of 65 (i.e. elderly share), which is expected to create a relatively bigger need for more social programs and should therefore enter the equation with a positive sign. In addition, we also check if the level of overall economic inequality, political constraints, government ideology, and fractionalization of parliament are related to significant increases in social policies. Finally, we also introduce an interaction term between our OEDC reform indicator and government ideology to check for the possibility that rightwing and leftwing governments might react differently to OECD reform recommendations. In other words, we introduce the interaction term to control for the possibility of an asymmetric effect of perceived reform need on social expenditure and social entitlements, depending on the political ideology of the government in power.

As shown in Table 6, all control variables are highly significant and enter the equations with the expected sign in equations 1 to 4, where the following change in social expenditure over GDP is the dependent variable. The situation is somewhat different for changes in welfare state entitlements (equations 5 to 8): here, average income and share of the dependent population are now insignificant, highlighting that the CWED is designed to capture the generosity of rules, not relative expenditure. Only in the case of political constraints we find a positive and statistically significant relationship with changes in welfare state entitlements. This means that a more constrained policy environment is also prone to increase welfare state entitlements to a larger degree. This could easily be the outcome of inter-temporal logrolling, or pork-barrel legislation.

Strikingly, the perceived reform need is unrelated to subsequent changes in social expenditure in all models (equations 1 to 4), highlighting that higher reform need is not associated with a following reduction in social expenditure, all else equal. Marginal effects corresponding to the interaction term in equation 4 also find no heterogeneous impact of government ideology on changes in social expenditure.[17]

Regarding the social rights measure, perceived reform need is unrelated to any variation in entitlements by itself (equations 5 to 8). When introducing the interaction term between OECD reform and government ideology in model 8, the latter enters the equation with a negative sign and government ideology becomes statistically significant at the 5% level. Marginal effects of OECD recommendations on changes in social rights, dependent on government ideology are shown in Figure 3. Findings indicate that left wing governments possibly react to OECD recommendations by increasing social rights, while right wing governments reduce them. Differences between both are not statistically significant at the 5% level though, making these results merely indicative.

Nonetheless, the latter finding is interesting, because it points out that welfare state entitlements and social spending are perceived as something different by the OECD and the respective executives in power. In this sense, the possible entitlement reductions are probably an expression of different ideological approaches to a welfare state reform processes, rather than an anti-welfare state consensus. Generally, our findings strongly contradict the impression that OECD recommendations are linked to systematic welfare state cutbacks or any substantial retrenchment in social expenditure.

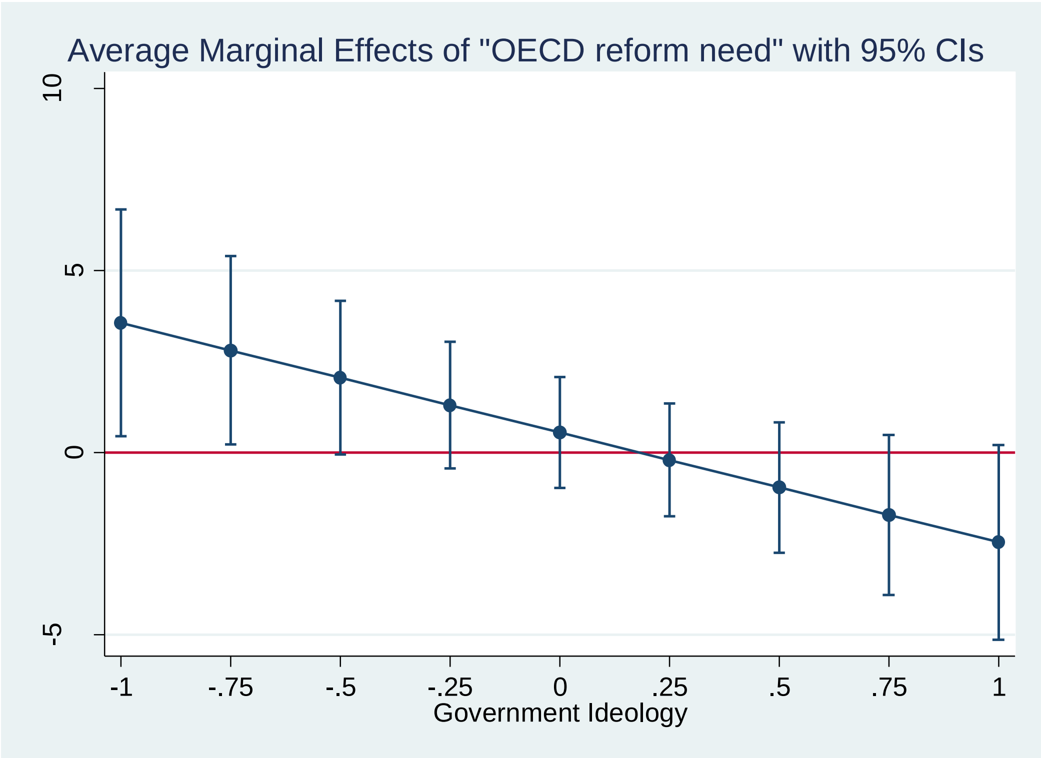
[17] This figure is not shown, but is available from the authors upon request.

Table 6 OECD reform outcomes

Dep. var.:	**Δ Social Exp.**				**Δ CWED**			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Social Exp./CWED	-0,114***	-0,115***	-0,118***	-0,120***	-0,553**	-0,552**	-0,519 **	-0,541**
	(-6,97)	(-6,90)	(-8,17)	(-8,61)	(-2,23)	(-2,21)	(-2,12)	(-2,66)
Log GDP p.c.	0,740***	0,738***	0,810***	0,820***	2,463	2,483	1,757	1,569
	(2,98)	(2,91)	(3,03)	(3,03)	(1,04)	(1,03)	(0,79)	(0,82)
Elderly share (65+)	0,047***	0,046**	0,042**	0,040**	-0,028	-0,040	0,013	0,139
	(2,95)	(2,79)	(2,73)	(2,47)	(-0,40)	(-0,54)	(0,17)	(1,40)
Gini coefficients	-0,003	-0,000	-0,003	-0,005	-0,151	-0,130	-0,178	-0,283**
	(-0,19)	(-0,05)	(-0,21)	(-0,35)	(-1,16)	(-0,95)	(-1,24)	(-2,05)
OECD reform	0,075	0,081	0,068	0,058	0,005	0,094	-0,003	0,550
	(0,59)	(0,62)	(0,55)	(0,44)	(0,01)	(0,11)	(-0,00)	(0,71)
Political Constraints		0,341				3,607**		
		(0,72)				(2,66)		
Gov. Ideology			0,040	-0,003			-0,136	1,554**
			(0,75)	(-0,03)			(-0,54)	(2,36)
Fractionalization			-0,881	-0,938			5,329	8,306
			(-0,88)	(-0,98)			(1,10)	(1,67)
OECD*Gov.Ideo.				0,075				-3,016**
				(0,57)				(-2,40)
N	68	68	68	68	61	61	61	61
Countries	23	23	23	23	21	21	21	21
Adj. R^2	0,60	0,61	0,63	0,63	0,23	0,23	0,24	0,42
F-statistic	16,5	13,3	17,5	15,5	8,1	7,8	7,9	7,2

Note: t-statistics in parenthesis; * significant at 10%; ** significant at 5%; *** significant at 1

Figure 3 OECD reform need, government ideology, and welfare entitlements



5. Conclusion: A “Washington consensus” for welfare states?

The policy advice in OECD Economic Surveys is typically motivated by the need to foster growth and prosperity, as indicated for example by Mahon (2009) and Armingeon and Beyeler (2008). Still, some worry that the scientific surface of this consensus masks an ideological agenda, directed at the destruction of European welfare states (Grinvalds 2010, Bradley and Stephens 2007). Strikingly, the debate takes place without any systematic analysis of the actual advice given by the OECD to its member countries, and without an examination of whether countries really do introduce substantial cuts to their social systems as a consequence.

An empirical analysis of the OECD Economic Surveys by means of our self-compiled database suggests that a “Washington consensus” for welfare states exists to some degree. The term Washington Consensus refers to a very rough description made in 1989 of the mainstream view in international organizations, such as the IMF, on what policies should be implemented in Latin America at the time (Williamson 2004). Our analysis suggests that, similar to the Washington consensus, reforms recommended by the OECD represent a mainstream agenda, favoring greater stability and efficiency, using guidelines from standard economic theory. Empirically, it is highly correlated with the well-known Economic Freedom of the World index by Gwartney et al. (2015). Particularly, the index dimensions related to government intervention in the economy, property rights security and quality of the legal system, and regulatory regime are found to play a crucial role in formulating reform advice. Of course, if someone perceives the EFW index to be loaded with a neoliberal content (cf. Peck 2010), that person will surely find our result to be supportive of the hypothesis that the OECD is indeed plagued by a neoliberal bias. Still, we find no indications that the comparative level of social expenditure or welfare state entitlements bear any relation to a higher reform need, while there is a focus on issues associated with a politically conservative vision of economics (Hibbs 1977, 1992) In summary, we find no indications of a specifically anti-welfare state bias, but our results might point to the existence of a “mainstream economics agenda” bias.

While it seems to be true that there exists a consensus on certain types of reforms, it is hard to find evidence that this consensus is hostile towards welfare states in general. After the crisis of the early 1990’s extensive welfare states were viewed as markedly more problematic, but most countries handled their problems without substantial welfare state retrenchment. We find no generalized trend that that perceived reform need is followed by changes in social expenditure or welfare state entitlements in any way. Only countries with a right wing government that were perceived to have a large reform need are perhaps also associated with subsequent reductions in welfare state entitlements, even though this is not certain in a statistical sense. The descriptive and empirical analysis thus supports the results of Castles (2002), who explores the extent, structure, and trajectory of welfare state reform in 21 OECD countries from 1984 to 1997, finding little or no evidence of systematic welfare retrenchment.

Similarly, our results that actual social expenditure is unaffected by OECD recommendations, while social rights might be somewhat reduced by conservative governments fits well with those reported by Starke et al. (2008), who examine if welfare states in the OECD converge and become more similar. They find some evidence of “moderate welfare state convergence” but add that it is “limited in magnitude, various in directionality and contingent upon the indicator under examination” (p. 975). Therefore, the possible entitlement reductions implemented by right-wing governments are most likely an expression of different approaches to welfare state reforms, rather than the existence of an anti-welfare state consensus. More research on this topic seems necessary to draw any firm conclusions on this debated issue.

Finally, it is interesting to note that the need for economic reform as perceived by the OECD declined massively in the years 1985-2005, but these changes did still not prevent the global financial crisis that emerged only a few years later. In addition, some countries that are often perceived to be in a state of slow economic decline since 2008, such as France and Italy for example, receive comparatively few recommendations in the mid 2000’s. Examining if countries with lower reform need fared relatively better during the financial crisis should therefore be an interesting topic for future research.

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