Chapter 13
Globalisation and the Composition of the Welfare State: Evidence From OECD Countries

Irina Araújo
University of Coimbra, Portugal

Marta Simões
University of Coimbra, Portugal

ABSTRACT

The aim of this chapter is to examine the relationship between globalisation and the size of the welfare state taking into account the respective composition. The efficiency hypothesis argues that globalisation leads to a reduction in the size of the welfare state since this can harm international competitiveness and drive away capital flows, while the compensation hypothesis poses that globalisation induces an increase in the welfare state in order to provide citizens with wider coverage against the risks of globalisation. This relationship is analysed for 31 OECD countries over the period 1980-2010 using data on social expenditures and the KOF Index of Globalisation and their different components. The results obtained indicate that overall there is a positive association between globalisation and the size of the welfare state, more intense for spending on housing-related benefits, active labour market programs and other social policy areas, and mostly felt through political globalisation. Globalisation loses significance for the explanation of family and unemployment benefits.

DOI: 10.4018/978-1-5225-4026-7.ch013
INTRODUCTION

In an OECD report from 2013, (Huwart & Verdier, 2013) ask whether the 2008 financial crisis that started in the USA but “affected most world financial markets almost simultaneously, then turned into an economic crisis in many countries.” (p.128) is a crisis of globalisation. Globalisation is defined by (Soubbotina & Sheram, 2000), pp. 66 as “(…) the growing interdependence of countries resulting from the increasing integration of trade, finance, people, and ideas in one global marketplace.” This phenomena is viewed by many as beneficial for the aggregate economy since countries can have access to more capital flows, technology, cheaper imports, and larger export markets. However, it does not usually imply that these benefits are shared by all and is also usually associated with higher economic volatility and makes the global economy more susceptible to economic shocks and crises, as the 2008 events have shown ((OECD, 2011)). An institutional feature that acts as a buffer against the economic and social impacts of crises is the welfare state, for instance by guaranteeing an income to those more vulnerable to labour market instability and also helping to recover from economic crisis by putting into action social spending multipliers through domestic expenditure that would otherwise disappear ((Furceri & Zdziennicka, 2012)). Nevertheless, this buffer has also been considered by many as under threat by globalisation, an influence that might undermine the ability of the welfare state and thus the role of government to contribute to post-crisis recovery¹. The main aim of this chapter is to empirically investigate whether this negative impact of globalisation on the welfare state is confirmed by the data highlighting the influence of the different aspects of globalisation, economic, social and political, and the effects on different components of the social spending. Since different components of social spending contribute differently to long run macroeconomic performance, in particular to human capital accumulation, the former assessment might also have important implications from an economic growth perspective ((Duarte, Simões, & Andrade, 2016)).

Social protection provided by the state can influence to an important extent the living conditions and standards of living of citizens. Social protection helps citizens face a number of contingencies such as unemployment, sickness or incapacity, also ensuring greater equality of opportunities, in particular in terms of access to education and health. However, an extensive social protection system is usually associated with higher labour costs for firms, e.g. in the form of social contributions/social security payments ((Ark, Stuivenvold, & Ypma, 2005)). The increasing economic openness of many countries has moved competition between firms into international markets, which can in turn encourage firms to relocate to low wage countries where the social security system is more limited and thus face lower labour costs in production, in order to become more competitive. This relocation, along with technological progress
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