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Devolved Social Security Systems: Principal-agent versus multi-level governance

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ABSTRACT

This paper presents an analytical framework for comparing patterns of devolution to subnational governments and autonomous social insurance institutions in social security systems. The framework has two components. One is an analysis of financial structures along the dimensions of financial autonomy (indicated by the extent to which the administering institution raises its own revenue or depends on central grants) and financial responsibility (indicated by whether marginal costs are borne by the administering institution). The other component of the framework concerns the assignment of policy-making power; in particular, we contrast the effects of competitive and cooperative modes of devolution. The discussion uses examples from Denmark, France, Germany, the Netherlands and the USA. While we looked for 'principal-agent' relationships between central governments and administering institutions, we found that more complex multi-level governance structures prevailed in most cases.

1. *Introduction*

This paper presents an analytical framework for comparing patterns of devolution in social security systems, and applies the framework to examples from five countries. It provides an additional perspective to existing frameworks in comparative social security research, which have tended to focus on eligibility and entitlement rather than institutional structures. Patterns of entitlement might seem to be a more natural focus for social policy research than institutional structures, because entitlement conditions may be expected to map onto welfare, income redistribution and other outcomes of central interest for social policy. However, it is also clear that many social policy debates and initiatives have institutional dimensions. For example, differences in retrench-

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ment policies and outcomes in different areas of social policy can be related to institutional structures (Pierson, 1994). More specifically, institutional structures and financial flows are very closely connected. In a time of general financial restraint in social security, the analysis of financial structures is important for understanding how financial pressures affect different areas of social security provision.

There are two main types of institution outside central government involved in the administration of social security benefits: subnational (local and state) governments and autonomous social insurance institutions, generally involving the 'social partners' (employers and unions). The two types of institution present different analytical problems, but there is one key common issue. We would expect, *a priori*, that local governments and autonomous institutions cannot implement their own redistributive policies under conditions of labour and capital mobility. Local governments would suffer from competition through territorial mobility, with high-tax, high-benefit localities seeing a loss of tax revenue through relocation of producers outside the territory (fiscal competition) and an influx of benefit claimants from low-benefit areas (social dumping). Insurance institutions which did not offer contributors a 'fair bet' (an expected value of benefits proportional to contributions) would see those with low expected benefits turn to competitors or self-insure.

These problems suggest that a redistributive social security system has to be centralised, and this is the standard conclusion in the public economics literature. However, in practice we do observe subnational governments and insurance institutions operating redistributive policies. One possible explanation is that they do so only as agencies of central government, with the task of implementing centrally-determined policies but without the power to formulate policies themselves. Principal-agent theory motivates much recent discussion among economists of the role of local government (e.g. Helm and Smith, 1987; Hughes and Smith, 1991; for a critical discussion of the agency approach in the context of social security, see Toft, 1996). Agency theory is also an important part of the 'New Public Management' approach to the reform of central government. From this perspective, administration by subnational governments or autonomous institutions should be understood as providing an alternative to administration by a central government bureaucracy; an alternative which is attractive because it allows scope for efficiency improvements through managerial autonomy.

In this paper we show that the financing structures and policy-making powers of subnational governments lend themselves to a principal-agent interpretation in only a few cases. Instead of straightforward agency relationships, we found systems of 'multi-level governance' where policy

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responsibilities are not vested in a single political body, and policy outcomes are strongly affected by intergovernmental relations. "In the analysis of multi-tiered systems, the interests and activities of constituent units assume central importance. The constituent units are autonomous political actors with the capacity to pursue (at least some of) their own policy options" (Leibfried and Pierson, 1995, 20).

The same situation applies to relationships between central government and insurance institutions. While there are some cases where an insurance institution administers a benefit as an agency of central government, the more widespread situation is that the social partners are important participants in the policy process. Just as local governments may lay claim to a voice in policy-making as representatives of their local electorates, so insurance institutions claim a voice on behalf of contributors. In a sense, contributors stand alongside central government as principals in relation to the insurance agency. This is reflected in governance structures where contributors (workers and employers) and beneficiaries are represented on boards of management.

There are many reasons why these arrangements have evolved, and this paper does not attempt to analyse all of them. Its aim is to show how different structures of multi-level governance may address problems in financing and administering social assistance and social insurance. Examples are presented where devolved institutions have significant policy roles, yet, at the same time, their ability to undertake redistributive measures is preserved. These are contrasted with examples where devolution *is* accompanied by a lack of redistributive capacity. Financial and policy-making structures are analysed to give some insight into these different results.

Several reform programmes in the countries under study are also discussed. Some reforms can be seen as endeavouring to replace multi-level governance structures with principal-agent relationships, so that the government is more clearly in control. Others, by introducing competition into devolved systems, appear to be seeking to control costs by reducing the redistributive capacity of the affected parts of the social security system.

2. *Data*

The study on which this paper is based encompassed five countries, chosen on the basis of sketchy preliminary knowledge of the institutions involved in administering social security, and also motivated by our awareness of issues under discussion and reforms in train. Briefly, Denmark was of interest because nearly all of its benefits, including its age pension, are administered by local authorities, although the rela-

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tionship between the municipalities and the government varies by benefit. Germany features numerous self-administered, independent or quasi-independent 'social partner' organisations whose constitution and powers vary according to the branch of insurance. The German social assistance scheme is highly localised, but its role and operation is significantly affected by Germany's Federal constitution. France was interesting because of conflict at the time between the management boards of the *Régime Général* and central government which saw them as failing to control expenditure and not acting in the general interests of taxpayers. The Netherlands were, at the time, undergoing changes which appeared to have implications for the future role of the social partners. Social assistance was financed by central government but administered by local authorities; this financial framework was under reform. In the USA Social Security (OASDI) is a Federal programme but other parts of the system are state-administered and some are partly state-financed. These structures were of interest because they were likely to raise issues around the setting of national guidelines and the management of regional variation in administration.

The research had three main components. We conducted some preliminary documentary work from secondary sources, to give some picture of the constitutional, legal and political frameworks in each of the five countries. With the aid of country counterparts, we obtained information on the institutions involved in the governance and delivery of social security and their roles in policy, operation, delivery, regulation and monitoring. Finally, we visited local, regional and head offices in each of the countries, meeting a range of case workers and officials at different levels, in organisations and departments dealing with information technology, audits, budgets, adjudication, training and other functions. The full research report (Bolderson and Mabbett, 1997) provides institutional overviews and accounts of the process of benefit delivery. The report also contains commentaries on the issues arising in each different country environment about the operation of the delivery system and the performance of the institutions involved, as seen by our interlocutors in each country and observed on the visits.

3. Limitations of Principal-Agent Relationships

In this section we present a framework for mapping out different structures of financial responsibility in devolved social security systems, and we develop some categories for analysing how policy-making powers might be divided up.

As a benchmark, we consider first the case where both financial

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responsibility and policy-making power are centralised. Centralisation clearly overcomes the basic problems affecting redistributive social security. By establishing a common set of eligibility and entitlement conditions, centralised policy-making precludes social dumping within the country (although not of course dumping across national frontiers). By financing benefits from national taxes, centralised financing ensures that subnational territories are not placed in fiscal competition. Furthermore, centralisation can remedy the lack of correlation between an area's tax-raising capacity and its welfare needs. By disbursing funds case-by-case as awards are made, the flow of funds in a centralised system results in an allocation of resources to each part of the country which is precisely in accordance with its needs, evaluated according to national criteria. Since the allocation is financed by central government, it is independent of each area's own resources.

Complete centralisation means that both total costs and marginal costs (case-by-case costs) are met centrally. The task of applying the central eligibility and entitlement conditions to each claimant may be given to a lower-level administrative body, but the local body does not bear financial responsibility for its decisions. Financial control therefore requires that central government verify or audit lower-level decisions, to ensure that the rules have been correctly applied.

While it is possible to have an agency administer centrally-determined rules, the absence of devolved financial responsibility limits the amount of decentralisation which can take place, and limits the prospective benefits of replacing a hierarchical-bureaucratic structure (i.e. local offices directly accountable to a central government department) with an agency structure. We would regard the case of the Benefits Agency in Britain as illustrating this point. Administrative budgets have been devolved, and managers have been given increased autonomy in organising offices. However, administrative budgets are very small compared with programme (benefit) expenditure, where the control mechanisms remain essentially bureaucratic.

For central government, maintaining bureaucratic monitoring and auditing systems is costly. This makes it attractive to devolve financial responsibility. The dilemma is that, if the agency is to manage a budget, it must be able to develop policies to do so. Central government may restrict these policies by establishing national rules on benefit levels and conditions of eligibility. However, the more prescriptive is the central framework, the more difficult it will be for the agency to ensure that its expenditure stays within a fixed financial allocation.

It is helpful for this discussion to distinguish between highly visible

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policy parameters, such as the benefit level or the income tapers, and policies which are more difficult to observe and monitor, such as the 'toughness' of decisions on voluntary unemployment, or the vigour with which evidence of cohabitation is pursued. An agency which has to comply with nationally-determined standards for the highly-visible parameters of the system might have to manage its budget by using low-visibility administrative measures. Indeed, this is half the point for central government, as administrative effort is costly to monitor. The difficulty is that budgetary responsibility may jeopardize administrative integrity if the agency is constrained to comply with a strong set of central parameters.

There is another 'degree of freedom' which can be introduced into the problem of finding a balance between policy-making power and financial responsibility. If the administering institution has some financial resources of its own, the financial control structure can become more flexible. However, an institution with its own financial resources cannot be a 'mere' agency, dedicated to serving only central government as principal. It must also be accountable to the insurance contributors or local taxpayers who generate its financial resources. Co-financing necessarily moves us into the world of multi-level governance.

We argued in the introduction that fiscal competition is a key constraint on the ability of devolved institutions to implement redistributive policies. To see how the constraints of fiscal competition might be overcome, we require an analysis of financial structures. Diagram 1 highlights two key dimensions of financial structure: the extent to which an institution has financial autonomy through meeting the bulk of costs from its own resources (vertical axis: share of total costs) and the extent of its responsibility for managing within a fixed budget (horizontal axis: share of marginal costs). The classic 'agency' case of devolving financial responsibility to an institution with no financial autonomy (through a block grant, for instance) is represented by cell (3) on the diagram. A 50/50 central/local split is represented by cell (5) (the axes are continuous, but the diagram is divided into cells for ease of exposition). Complete autonomy is at (9); the case where the local or autonomous institution meets the bulk of costs from its own revenue, but calls on central government at the margin is at (7).

Our discussion has suggested that costs of monitoring and auditing are a significant issue in the structuring of central-local relationships. It is important to recognise that these costs vary considerably according to the rules of the benefit in question. Social assistance benefits are demanding to administer, because they tend to require high levels of evidence about the claimant's income and household circumstances (Mabbett and Bolderson, 1998). There are therefore significant mon-

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DIAGRAM 1: *A framework for analysing financial responsibilities in devolved systems*

Share of Total Costs	Share of Marginal Costs		
	centralised		*devolved*
centralised	(1) Central government meets all programme costs	(2)	(3) Large central government contribution in 'block' form
	(4)	(5) 'Matching' formulae (e.g. benefit costs split 50/50)	(6) Government pays for specific purposes or categories (e.g. 'insurance-alien elements')
devolved	(7) Mainly financed autonomously, but government covers deficits	(8)	(9) Entirely autonomous provision

itoring and verification problems for central government in this area. By contrast, universal benefits such as child benefit have few evidentiary requirements and call for limited evidence-collection effort on the part of the agency. The same is usually true of old age pensions, although these may be affected by other sources of income and by household circumstances (i.e. whether the pensioner is living alone or not), making their administration slightly more problematic. Insurance-based unemployment and disability benefits do not usually require verification of income and household circumstances, but adjudication on the fact of unemployment or disability itself may raise issues.

In view of these different characteristics of different benefits, it is not surprising to find that straightforward examples of centralised financing on a case-by-case basis, i.e. location in cell (1) in Diagram 1, arise most often in the cases of child benefit and old age pensions. For example, in Denmark, old age pensions and child benefits are administered by local authorities but claims are paid directly from central government accounts. Not surprisingly, central government controls policy with respect to these benefits, and the relationship between central government and local authorities in this part of the system can readily be characterised as a principal-agent relationship. Furthermore, this is a principal-agent relationship in which direct control (exercised by setting out the basis for awards in law and auditing local authorities' compliance with the law) is maintained in preference to financial control. Local authorities do not bear the marginal cost of their awards of these

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benefits. Local authorities do meet the costs of *administration* out of their general funds, so it might be argued that the system is based on a policy-delivery split in which agencies have incentives to pursue administrative efficiency.

Other countries provide examples of insurance institutions, rather than local government, administering tax-financed benefits as agencies of central government. For example, in the Netherlands family allowances are administered by the Social Insurance Bank, while in France the minimum old age pension is administered by the old age insurance bodies.

In the following two sections, we discuss examples of social assistance and social insurance benefit administration which are not located in cell (1). We map out the financial arrangements for, first, social assistance benefits administered by subnational governments and, second, benefits administered by social insurance institutions. Ideally, Diagram 1 would include a third dimension related to the assignment of policy-making power, but we have not found a simple graphical representation of this aspect of multi-level governance. However, we draw out issues relating to policy-making in the discussion.

4. Examples of decentralisation to subnational governments

In all of the countries in our study, subnational governments (local or state) are involved in the administration of social assistance, which, as noted above, is a difficult type of benefit to administer. In four of the five countries there are elements of local financial responsibility for social assistance. The exception is France, where the national minimum (*Revenu Minimum d'Insertion*, RMI) is centrally-financed (i.e. location in cell (1)). Dutch social assistance has also been centrally-financed, but it is in the throes of a reform which is intended to grapple with principal-agent problems in administration. Evidence of fraudulent claiming of social assistance led central government to develop the view that local authority administration was insufficiently stringent: in particular, that local authorities were failing to detect cohabitation and unemployed people working while claiming. Central government auditing and other mechanisms of administrative control evidently proved inadequate to ensure that the benefit was administered as central government desired. Recent reforms have transformed part of the local authorities' social assistance allocation into a block grant, a horizontal move towards cell (3) on Diagram 1. This reform constitutes an attempt to use financial incentives and constraints where direct administrative authority relationships have failed to meet central government's objectives.

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A feature of the Dutch reform was that central government aimed to maintain its control over the main parameters of policy (benefit levels and entitlement conditions). Municipalities were pressed to manage their budgets through administrative measures, such as increased visiting of claimants. However, it proved impossible to achieve financial control through these measures alone, and municipalities were given (minimal) policy-making powers. Under the 1996 Social Assistance Act, national basic amounts of social assistance are set out in the law, but policies on supplementing the basic amounts, where they are inadequate, are now developed by the municipality and laid down in municipal regulations (MISSOC, 1996, 45).

It remains to be seen whether municipalities with high social assistance needs and low resources will adopt less generous supplementation policies than wealthier municipalities. If the block grant from central government is 'about right' for the needs it is meant to meet, then there should not be systematic (wealth-related) variations in policies across municipalities. The difficulty in getting the block grant right is to obtain adequate indicators of local needs. Statistics collected independently of administrative tasks are liable to be insufficiently comprehensive or up-to-date, while administrative data may themselves be affected by local administrative practices, which reduces the efficacy of the budget in controlling agency behaviour.

Another issue which faced the Dutch system concerned agency incentives to comply with budgets, i.e. to accept financial responsibility. Dutch municipalities have limited financial resources of their own, and correspondingly limited policy-making power and influence. This may mean that local authorities see themselves as having little to lose from noncompliance. Where an administering body has important policy roles, outside principals (local electorates or contributors) may gain something in the authority, power or influence of their agency as a *quid pro quo* for operating within financial constraints. This gain is not present where the administering authority has no policy-making power. The propensity of Dutch local authorities to put themselves into central government administration suggests that lack of incentives to comply is a non-trivial problem (Bolderson and Mabbett, 1997, 178).

In Denmark, Germany and the USA, there is financial participation by subnational governments in social assistance, i.e. structures located down and across from cell (1) in Diagram 1. The results of local financial participation are quite different across the three countries. Basic benefit levels are uniform across Denmark and very similar across the German Länder (the basis for determining the benefit level is set out in Federal law, while the actual level is set by the Land). By contrast, in the USA benefit levels for AFDC (Aid to Families with Dependent

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Children; now TANF (Temporary Assistance to Needy Families)) vary widely. In the remainder of this section, we attempt to explain these divergences by reference to the financial arrangements and policy-making structures operating in each country.

In Germany, local authorities are financially responsible for social assistance. German local authorities receive some revenue directly from the centralised taxation system, which distributes revenue across territories according to a combination of origin-basis and equalisation formulae. They also receive some revenue from local taxes and fees, and receive Länder grants. In so far as none of these sources of revenue is directly tied or earmarked to social assistance, one could say that local authorities meet the cost of social assistance themselves (apart from about 1% coming from the Federal government for refugees and other 'international' cases). The burden of marginal costs also falls in the first instance on local authorities, who have responsibility for managing their budgets. Thus, in terms of Diagram 1, German social assistance is located in cell (9). If social assistance costs exceed budgetary projections, they may borrow (within limits), increase local revenue from fees and charges, or cut other local expenditure.

An important problem with this structure is that expenditure must be managed to conform to the revenue yielded by the assigned taxes, which means that the structure is inflexible to changing demands on social assistance. At the local level, this problem can be 'smoothed out' by subventions from the Land to a local authority facing particular difficulties, but any general increase in social assistance claims (e.g. due to an economic recession) exposes the rigidity of the system. This contributes to reliance on insurance benefits in preference to assistance, a preference strongly reinforced by the voice of the Länder in the Federal upper house of parliament (the Bundesrat) (Pierson, 1995, 458).

The Danish system is more flexible in generating increased allocations from central government to local authorities in the face of any general increase in social assistance expenditure. Social assistance in Denmark is administered by the local authorities and financed 50% by central government on a case-by-case basis, and 50% from a block grant, which puts it in cell (5) on Diagram 1. What is particularly interesting is how the block grant is determined. *Ex post*, the block grant covers total social assistance expenditure for the country, although for any particular local authority it may deviate from actual expenditure because the allocation is determined by a formula which attempts to distinguish idiosyncratic and systematic factors in each local authority's spending. A critical feature is the interaction which determines the total level of spending. On one hand, central government can try to put pressure on local authorities to restrain expenditure on social assist-

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ance by announcing *ex ante* budgets for each authority based on a low estimate of the likely total expenditure outturn. Equally, local authorities can raise the outturn (and therefore the final settlement) by spending above budget. The better the coordination between local authorities, the greater their leverage in this process. Central government is aided in its efforts at expenditure control by those local authorities which aim to be low spenders, and adopt tough administrative practices, for example in their implementation of employment programmes. (Where such measures succeed in producing idiosyncratically low expenditure, they generate a surplus on the block grant which can be used to reduce local taxes.) However, balancing the impact of the low spenders is the activity of the central association of local authorities (*Kommunernes Landsforening* (KL)), which disseminates information on the law and endeavours to establish common administrative standards, for example by running training programmes. A further check on local practices is provided by the appeal system.

At first sight, a great deal rests on the budget formula in this system. However, it is probably ultimately more important that the parties do not 'play the system' too much, so that the idiosyncratic component of expenditure is kept within bounds. This is achieved partly by the establishment of common national standards for easily-observed parameters such as the basic benefit levels. To maintain common administrative standards, central government has sought local agreement on the general principles involved in innovations such as the 'activation' programmes which have operated in recent years. The Danish model avoids the arbitrary demands on administrative control which characterise situations where an agency is called upon to manage a centrally-determined block grant, as in the Dutch example. Arbitrariness is reduced essentially because the municipalities have more power than in the Dutch system (Page, 1991). Their association has a central role in the development of administrative practices and in the negotiation of budgets (Tonboe (1991, 25) describes KL as a 'second chamber' of parliament). The balance of budgetary power is less centralised: decisions of the municipalities affect the total level of spending, although the municipalities simultaneously have individual incentives to control spending. Finally, Danish municipalities have more independent financial resources than their Dutch counterparts, enabling them to bear financial responsibility without recourse to covert administrative practices, although there are policy differences between municipalities on the choice of appropriate administrative practices.

By contrast with the European systems under discussion, the fate of social assistance in the USA would seem to support the hypothesis that decentralisation of assistance leads to fiscal competition and social

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dumping, with benefit levels subject to a 'race to the bottom'. Before the recent welfare reforms, AFDC was financed by the states with Federal Financial Participation (FFP) in the form of matching funds (putting the system in cell (5) of Diagram 1). While the Federal match was intended as an incentive to operate anti-poverty policies, the reality is that it constituted a very weak form of leverage over the states. The matching formula for AFDC did not serve to equalise resources between low-income and high-income states. Despite enhanced match provisions for low-income states, high-income states paid higher benefits and therefore enjoyed higher levels of Federal assistance per benefit recipient.

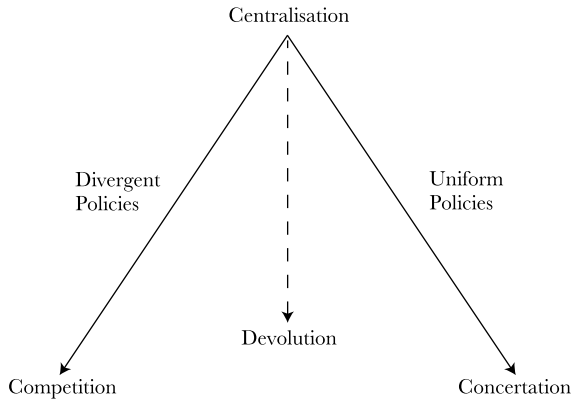
A striking feature of the American situation was that matching financing did not mean that the Federal government could comfortably allow the states autonomy in their administration of AFDC. Instead, a lot of Federal administrative resources went into verifying the expenditures for which matching funds were claimed. Underlying this effort was a relationship between the Federal government and the states in which trust was low and rivalry for control of the welfare agenda was high. Concern about claimant rights (specifically, about racism in administration) may be one reason why the structure of AFDC in the USA, prior to recent reforms, allowed states to vary highly-visible parameters (the needs standard and the benefit level) but imposed stringent Federal monitoring of their administrative practices.

From the mid-1980s onwards, states gained the upper hand in claiming the right to administer AFDC as they pleased, as the policy environment became increasingly anti-welfare. Furthermore, anti-welfare interests recognised, in the promotion of 'States' Rights', an institutional strategy which would serve their policy aims (Pierson, 1995, 453). In the face of these pressures, the Federal government allowed more 'waivers' of federal administrative requirements, making benefits more conditional on claimant behaviour. The culmination of this process was the Personal Responsibility and Work Opportunity Act of 1996, which converted the Federal component of AFDC funding into a block grant. While there are concerns about how the block grant system will work when demands on assistance increase in the next economic downturn, the issues of information and compliance (noted above in the example of the Netherlands) which arise when block grants are given to agencies to deliver national policies do not arise in the case of TANF. This is because the national policy framework is minimal, and states have extensive powers to determine policies on both the parameters of the system and (nowadays) its mode of administration.

We can summarise some of the differences between Germany,

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DIAGRAM 2: *Devolution in policy-making*



Denmark and the USA by reference to Diagram 2. This diagram simply illustrates that devolution may go down two very different paths: competition and concertation. The term 'concertation' is used here in the same sense as by Hayward, who distinguishes consultation from "the closer, sustained collaboration of concertation, corresponding to a shift from involvement in a policy network to a more selective, intimate policy community, where a greater measure of consensus can be expected and is regularly achieved" (1995, 229). A prerequisite of concertation in this context is the ability of the devolved units to establish a common strategy, and concertation is therefore related to the development of associative-cooperative relationships between the devolved units (e.g. through KL in the Danish case or through the influence of the Länder in the Bundesrat).

As indicated on the diagram, devolution down the concertation axis is consistent with uniformity across units for key policy parameters such as benefit levels, and indeed with the operation of similar administrative practices and with a consensual orientation towards welfare policies. We would also see the relationship between the devolved units and the centre on the concertation axis as being one of influence and cooperation, whereas competition among the devolved units may be exploited or managed by the centre, but does not lend itself to negotiated outcomes.

Diagram 2 has no particular claim to originality; for instance the contrast between cooperative and competitive federalism is well-established. The distinction between competition and concertation is very similar to that drawn by Scharpf (1988) in contrasting the American and German versions of federalism. Scharpf highlights the power

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of the Bundesrat and the Bund's dependence on the Länder for implementation (the Bund lacks its own administrative structure) as key factors leading to power-sharing rather than competition.

The processes of fiscal competition and social dumping mean that devolution down the 'competition' axis will be associated with weak redistributive policies, whereas devolution down the 'concertation' axis is compatible with redistribution. Pierson (1995, 466) emphasises how important the degree of fiscal equalisation is to this outcome. The ability of constituent units to adopt a concerted policy will depend not only on their political orientation but also on their financial capacity. Poor states will be unable to participate in a concerted redistributive policy unless supported by equalisation arrangements.

One effect of competition is to reduce the importance of political processes and increase the impact of economic pressures and constraints. Advocates of competition between subnational governments argue that it increases governments' responsiveness to affected populations through channels other than the electoral process. On this Tiebout-inspired view, the process of fiscal competition (for example) is something to be encouraged rather than suppressed. "It encourages greater government responsiveness to consumers/voters, has a positive effect on cost containment, and no longer is something to be eliminated by tax harmonization or other forms of tax coordination" (Groenewegen, 1990, 103). This public choice view of public sector reform has been most influential in the USA.

Obviously the discussion in this section implies that Denmark and Germany operate along the concertation axis and the USA along the competition axis. However, it is important to recognise that these may not be fixed positions. The US states do have channels for associative action and their common interests vis-a-vis the Federal government have sometimes led to concerted strategies. The associative harmony of the Danish municipalities is always open to tension, for example arising from divergence between the interests of prosperous and poor areas. In Germany, the formal constitutional powers of the Länder allow them more autonomy than they have exercised in, for example, the setting of benefit levels. Pronounced inequality across regions (particularly East versus West) has put the relationships between the Länder under pressure.

Comparing the pattern of policy influence over social assistance in Denmark, Germany and the USA with the situation in France and the Netherlands, it is clear that there is a complementarity between local financial contribution and the assignment of policy-making power. While financial responsibility is a burden on the locality, it leads to greater local influence and credibility in policy debates over levels and

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types of needs, making for a more pluralistic policy environment than in a centralised funding system. However, it is also clear that, if the aim is to promote redistributive measures, then policy *influence* is more valuable than policy *autonomy*. Local influence is compatible with highly-developed social assistance systems, whereas local autonomy can lead to the adoption of competitive policies, rendering the system vulnerable to a 'race to the bottom'.

5. *Policy, administration and financial control in social insurance*

In this section we examine the relationships between central government and social insurance institutions. The first problem we face in characterising social insurance systems is whether they really constitute devolved systems. In some cases, it may be appropriate to see a social insurance body as essentially a government department by another name. For example, the Dutch Social Insurance Bank (*Sociale Verzekeringsbank*, SVB) is headed by a representative board which advises the minister, while supervising a network of offices organised along bureaucratic lines.

One alternative to this model is that policy and administrative functions may be separated, so that the social insurance body is, in effect, a central government agency. In the countries in our study, there are examples of insurance institutions acting as agencies in the delivery of some benefits, while having both policy and administrative roles in respect of other benefits. For example, the Federal Employment Institute (*Bundesanstalt für Arbeit*, BA) in Germany has both roles in the area of unemployment benefits, but only a delivery role in child benefits. In general, however, the agency functions of social insurance bodies are an afterthought, arising when an established administrative infrastructure is utilised by central government in preference to developing a new bureaucracy for a new benefit.

Another alternative is that social insurance institutions are parts of a system of multi-level governance. The root of multi-level governance in social insurance is the insurer's accountability to contributors. This is indicated by the extent to which the interests of contributors are separately identified, represented and protected in the governance structure. One of the issues in determining the extent of contributor protection is that the interests of contributors are often mediated through the social partners, yet, at the same time, the social partners may occupy institutional positions in policy-making which have little relationship to their role in protecting the interests of contributors. We can contrast the 'individual contributor protection' model developed in the USA with the social partner-based pattern characteristic of contin-

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ental European systems. In the USA, measures to improve the security of contribution-based Social Security entitlements were accompanied by the removal of the Social Security Administration from direct executive control. Protection of contributors' interests falls to the Commissioner and the Advisory Board, which report to Congress. The European pattern is for the boards of social insurance institutions to be made up of appointed or elected representatives of the social partners. The degree of autonomy enjoyed by insurers reflects the position of the social partners in policy-making, and therefore has to be seen in the context of the tripartite, corporatist structures which can be found across a range of policy areas.

In systems of multi-level governance, administrative institutions have channels for influencing policy. This distinguishes them from agencies, on the one hand (which have no policy role) and interest representation in policy-making, on the other hand (where the interest groups have no implementation role). Formal representation of the social partners in administrative structures is widespread in the countries in our study. However, their influence on administrative decision-making is quite limited. One channel of influence is that the social partners may develop rules on unemployment or disability which reflect specific industry conditions. However, in the 1990s governments have tended to try to countermand such rules in order to promote labour market flexibility. They have a variety of ways of doing this. In the area of disability benefits, a great deal rests on how the medical profession is incorporated into the administrative structure, while adjudication on unemployment may involve a state-run employment service, operating alongside the social partner-run insurance institution. Furthermore, the training and 'ethos' of insurance administrative staff may be essentially governmental and bureaucratic, and relatively independent of social partner influence.

The Netherlands provides one example in our study where the social partners were seen as affecting the way benefits were administered. Commentators have attributed the huge growth in disability rolls in the 1980s to the control exercised by the social partners over the Industrial Insurance Boards (the BVs) (Aarts and De Jong, 1996). (This view has been disputed, on the grounds that the government at the time was broadly in favour of an 'exit' (early retirement) strategy for managing unemployment. The partners acted "without the official (but with informal) consent of the Dutch government" (Blomsma and Jansweijer, 1997, 226).) A commission of enquiry accepted the 'failure of governance' view, and recommended that policy and implementation should be more clearly separated by restructuring the institutions involved. The outcome is that the social partners now have a place on the peak

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supervisory board for social security, but their involvement in lower-level administration has been removed. Furthermore, administration is now conducted by private institutions under contract. The verdict of the OECD is that "[t]his should keep vested interests at arm's length and make it harder to undermine the intentions of legislators at the implementation stage, in contrast to what seems to have happened in the past" (OECD, 1998, 79).

In Denmark, the administration of unemployment insurance by offices with strong trade union connections has been the subject of some criticism. A striking feature of the Danish case is that, while the trade unions exercise 'street level' influence on unemployment insurance, and also benefit from the linkage between joining a union and obtaining insurance cover, administrative control is not matched by influence over peak-level policy. Unemployment insurance is largely state-financed (located at (4) on Diagram 1), and policy is developed by the government. While the government consults with the social partners in this area (as in many others), this policy process is mediated through institutions which are quite separate from the administrative structure.

Given the legal and bureaucratic nature of much social insurance administration, it is tempting to see social insurance institutions as interest-representing structures with essentially consultative functions. However, many insurance institutions have their origins in collective agreements between trade unions and employers, and the social partners continue to exercise an influence on policy which is closely related to their power in the labour market. Furthermore, social insurance institutions have a degree of formal financial autonomy because they manage a dedicated source of revenue, in the form of employer and employee contributions. As the following examples show, this autonomy may be compromised by reliance on central government funding at the margin. Furthermore, there are issues about whether contribution revenue should be seen as a 'social burden' rather than a cost incurred by 'private' agreement between employers and unions.

Government financial participation is a common feature of social insurance systems, but there are important variations in the nature of this participation. In Germany, the government makes a subvention to the old age pension system to cover the cost of 'insurance-alien' measures (credits for time spent bringing up children and the minimum pension for those with a long contribution record). While the subvention is negotiable in the light of actual costs, it is structured as a lump allocation. This leaves financial responsibility primarily with the management of the insurance institutions (i.e. marginal costs are borne by the institutions; cell (6) in Diagram 1). Although the government is

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inevitably drawn into the task of maintaining financial balance in the old age pension system in the longer term, it has avoided making any open-ended financial commitment. By contrast, the government does routinely underwrite the finances of the Federal Employment Institute (BA), which we would see as the least autonomous of Germany's social insurance bodies.

In France, the insurance institutions of the *Régime Général* (RG) have run deficits which they have covered by borrowing. This borrowing is effectively government-guaranteed, i.e. the state meets the deficit. In terms of Diagram 1, the burden of marginal costs falls on central government, although the bulk of total costs is covered by contributions, i.e. the system is at (7). The difference between the BA and the RG is that the government's financial exposure in the former case is matched by a high level of policy influence, whereas the assignment of policy-making power in the RG is more contested.

What factors lead to a contest over policy control between the government and insurers? Where insurance arrangements have been made mandatory by administrative extension of collective agreements, the social partners enjoy an institutional monopoly in setting the level and structure of provision. The outcome may be satisfactory to the government if bargaining between the opposing sides (employers and unions) leads to a 'middle' outcome that is consistent with the general public interest. The French idea of *paritaire* in the governance of social insurance is that the contest between capital and labour should lead to a 'balanced' social outcome, but one of the problems in France is that this has not been so. The social partners have tended to agree on contribution rates which the government regards as too high, and liable to add to unemployment. Similar issues have arisen in the Netherlands, whereas in Germany the government has been able to rely more on employers to press strongly for restraint of social insurance costs.

In France, the government has embarked on a restructuring of social security financing, whereby it has increased its financial contribution to social insurance in order to reduce the contributions burden on employers. Bonoli (1997) argues that this financial restructuring can be seen as the counterpart to the government's attempts to assert greater influence over the conduct of social security policy; in particular, to implement measures which depart from insurance principles. The state's financial contribution (which takes the form of revenue from a dedicated tax on all personal incomes) meets the cost of the most explicitly redistributive elements in the social insurance system: i.e. the minimum old age pension, part of family benefit expenditure, and supplements to unemployment insurance for those who would not otherwise be entitled. In addition, a temporary tax is in place to service the debt.

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One motive for this restructuring is the government's desire to reduce labour costs and promote employment. To do this, the government is restraining insurance provision based on employment, where once it promoted such provision through the administrative extension of collective agreements. However, the government cannot prevent the social partners making insurance agreements 'voluntarily' or 'privately'. In France, the social partners' decisions on the operation of the second-tier pension schemes (ARRCO and AGIRC) have sometimes supported, but sometimes undermined, government reforms of the first tier (Reynaud, 1997).

Reforms in the Netherlands also show how the contest between capital and labour may fail to lead to a social outcome which is 'balanced' in the eyes of the government. In the Netherlands, disability pensions were used as combined unemployment/early retirement benefits during the 1980s. It suited employers as well as unions, in the face of restrictive redundancy laws, to deal with industrial restructuring by offering generous pathways into retirement. Short-term sickness benefits were also generous, and levels of sickness absence were high. It could be argued that, since the pensions and benefits are financed from payroll contributions, the costs fall on the social partners themselves, and it is their task to regulate the costs they incur. However, this ignores the government's interest in the (un)employment externalities which result from these arrangements. Furthermore, the insurance arrangements originated in collective bargaining but have been made mandatory throughout industry by government action, and so are treated by the government as a 'collective burden' rather than a private cost.

To curtail what was perceived to be an excessive level of sickness absence, the government reduced benefit levels (replacement rates). However, employers and unions then reached agreements which topped up provision, restoring the previously-established levels of benefit ('gap insurance'). For the government, this was an unsatisfactory outcome, as the public policy problem arising from the employment effects of high-cost settlements between employers and the 'insider' workforce remained.

The government then acted to reduce the ability of employers to insure their sickness benefit costs. The reform process culminated in the abolition of the public insurance system in 1996. Employers can insure against sickness absence with private insurers, who levy experience-rated premiums. By introducing competition into insurance provision, and thereby promoting the spread of experience-rating, the government altered the incentives facing employers, in effect enlisting them in its efforts to reduce sickness absence and the accompanying

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costs. However, the reforms also reduce the capacity of the sickness insurance system to redistribute from low-sickness to high-sickness employers, and thereby create an incentive for employers to avoid taking on workers with adverse sickness characteristics.

The connection between competition, cost control, and loss of redistributive capacity is also apparent in the case of sickness insurance in Germany. The German sickness insurance funds (*Krankenkassen*, KKs) have been allowed to compete for members since 1996. The government's aim in introducing competition was that funds would endeavour to restrain their costs in order to attract members by levying lower contribution rates. However, because insurers might also try to reduce costs by selection of risks, the government has encountered some difficulties in establishing an appropriate basis for competition between KKs. The regulatory framework remains quite substantial. KKs are required to offer the same policy to all members, and they have limited ability to refuse cover to anyone who belongs to their member base. Most of the KKs are enterprise or sector-based but there are also territorial KKs. The territorial KKs carry most of the bad risks: a consequence of the inherent exclusivity of employment-based schemes. The Federal Insurance Office operates a financial equalisation arrangement which is meant to limit inequalities in contribution rates arising from selection of risks, but the territorial KKs argue that they are inadequately compensated for the risks they carry, and their contribution rates tend to be higher (Bolderson and Mabbett, 1997, 143).

In the discussion of devolution to subnational governments, we contrasted devolution to bodies which act in concert and devolution to bodies which compete. The examples of Dutch and German sickness insurance show that the conclusion reached in that discussion, that competitive devolution undermines redistributive capacity, also holds for insurance systems. In general, social insurance systems are located on the concertation axis of Diagram 2. A feature of social insurance institutions based on social partnership is that there may be a number of insurance providers in the system, but they do not compete. Competition is suppressed at the stage of labour market organisation, where unions agree on occupational and industrial demarcations of the workforce, and settle their differences over bargaining strategies. A system in which unions or associations competed with each other to organise groups of workers, obtain negotiating rights with employers and run insurance schemes would not be recognisable as a system based on social partnership. One consequence is that the establishment of competitive relationships between insurers is likely to be accompanied by privatisation, i.e. the introduction of noncooperative players. The

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German case is unusual in that the prior existence of a large number of providers organised along diverse lines (occupational, territorial etc) meant that it was possible to introduce competition without privatisation.

It may seem strange to argue that social insurance systems are based on concertation, when they have at their heart the class opposition of employers and unions. However, if this opposition is resolved through co-ordinated bargaining, there is no contradiction between class conflict and concertation. Furthermore, to the extent that concertation restricts competition between employers – for example, by subjecting all employers to a uniform contribution rate – the degree of class conflict in the system is ameliorated. From this perspective, we can link some of the current problems with social insurance systems to the decline of co-ordinated bargaining more generally, which itself partly reflects the intensification of competitive pressure on employers arising from increased economic openness.

In terms of Diagram 2, there are two directions in which social insurance systems can move if devolution with concertation breaks down. They can remain devolved but become competitive, or they can become less devolved, with central government asserting more control over social insurance. We would suggest that the general tendency is for governments to reduce the autonomy of social insurers. This is particularly a feature where bargaining between employers and unions generates outcomes which are unresponsive to wider competitive pressures. Governments may be more concerned than the social partners about various forms of 'exit' from the insurance system, such as capital outflow leading to reduced job creation, and the diversion of employment into uninsured, informal activities.

Generally, governments are not lacking in the formal powers necessary to curtail the autonomy of insurers. Contribution rates and benefit levels are often formally set by the government. It may be the case that the recommendation of the insurers has always been accepted, so the government is faced with achieving a change in established practice rather than a formal change in the governance structure. Similarly, management boards of insurance institutions may have dominated the initiation and development of policy proposals, even where government approval is required for policy changes. The initiation of policy by new players and the creation of new policy-making bodies are therefore significant in reducing the influence of the social partners. For example, in France the development of reform plans was led by the Prime Minister and accompanied by special conferences and forums, while new institutions have been put in place in the Netherlands.

On the other hand, governments' formal powers over social insurance

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systems do not mean that they have the power to prevent employers and unions reaching 'private' agreements which undermine the government's policy aims. The government cannot exercise complete central control over insurance unless it prohibits private insurance arrangements. The introduction of competition in areas where the social partners currently enjoy monopolies of provision may therefore be used to contain the cost of private agreements, as in the sickness benefit examples. However, as we have seen, this strategy brings with it a loss of redistributive capacity, placing greater burdens on central government's own redistributive policies.

6. Conclusion

The aim of this paper has been to describe and categorise patterns of devolution in social security, and to draw out some of the issues which arise from different patterns. We have concentrated on examples where financial responsibility is devolved to subnational governments and autonomous social insurance institutions. Devolution of financial responsibility in social security is accompanied by the involvement of those institutions in policy-making, but not necessarily by policy autonomy.

We began with the hypothesis that subnational governments and autonomous institutions are constrained in implementing their own redistributive policies. There are two main channels through which they may influence policy despite this constraint. First, they may have leeway to make their own decisions over the detail of policy, while complying with centrally-determined parameters for high-visibility aspects of the policy, such as the benefit level. Second, subnational governments and autonomous institutions may act in concert to influence national policy. We found that the first channel was important in the administration of social assistance by subnational governments, but administrative influence was less significant for insurance institutions. The second channel was important for both types of institution.

There are a number of themes in current debates on social security which implicitly challenge established systems of multi-level governance. Perhaps the most radical is the view, based on the Tiebout model of government choice through geographical mobility, that competitive policy-making by subnational governments should be encouraged. The implications of this view for social security can be seen in the fate of AFDC in the USA.

Turning to social insurance, it appears that the established fabric of multi-level governance in social insurance is under a lot of pressure in

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the countries under study. Partly this can be seen as a general result of stagnant employment levels and high long-term unemployment, but there are also specific effects on social partnership arising from the decline of traditionally highly-unionised sectors and the breakdown of centralised wage-fixing arrangements. These changes mean that both the legitimacy of the social partner organisations and their ability to deliver desired outcomes (e.g. wage restraint in 'exchange' for enhanced insurance) are in question.

More generally, there is the view that social insurance is in a 'crisis' requiring radical government action, which slow consensual policy processes impede. The effect of multi-level governance on the quality of social security policy-making and implementation is open to debate. There is a strong current in political theory which sees participation in policy-making by interest associations as having a positive effect on the quality of policies, both in formulation and implementation (Berger, 1981; Goldthorpe, 1984; see also Cohen and Rogers, 1995). There is also a well-established identification of decentralisation with democracy in many European countries (Sharpe, 1993, 14–16). Equally, multi-level government has its critics, perhaps most famously Scharpf with his analysis of the joint decision trap (1988). To some extent the different views derive from different values placed on representation on the one hand and efficiency and rationality in the policy process on the other (Sbragia, 1992, fn. 80). A further issue is whether the participating sub-national governments and autonomous institutions really act as representative institutions, or whether their incentives instead revolve around their own institutional self-interest. Advocates of centralisation tend to see a direct relationship between a single government and its constituents as having the least potential for institutional capture.

Finally, this study has not sought to investigate the capacity of central government to implement redistributive policies, yet it must be acknowledged that national social assistance in Europe is under pressure from population movements, while redistributive elements in social insurance are seen as reducing national competitiveness. A multi-level governance framework is valuable for analysing the issues presented by the increase in labour and capital mobility in the European Union and the increasing competence of European-level institutions of government, as Leibfried and Pierson (1993) have argued. Our analysis has shown that centralisation is not essential to maintaining the social security system in the face of goods and factor mobility. However, we have also suggested that *concertation*, consensus-building and the suppression of competition between provider institutions are important in a devolved system, and this presents something of a challenge in the European context.

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