DECENTRALIZATION, INTERACTIVE GOVERNANCE AND INCOME INEQUALITY: A COMPARATIVE STUDY

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This dissertation argues that decentralization leads to higher income inequality, and that interactive governance –the level of 'shared-rule' between central government, regional governments and social actors–, is associated with lower income inequality. I use a mixed-methods approach – combining a large-N quantitative analysis with in-depth studies of the cases of Spain, Germany, France and Sweden. In my quantitative study of 17 OECD countries, I find that in countries where subnational units have higher fiscal self-rule (higher fiscal decentralization), there is higher income inequality. Conversely, more shared fiscal rule between the subnational regions and the central government is significantly associated with less income inequality.

This dissertation contributes to the literature on federalism, decentralization, governance and inequality in both theoretical and empirical ways. I disentangle the political, administrative and fiscal aspects of decentralization quantitatively, and I also explore different types of decentralization qualitatively with the elite interviews conducted in the four countries. Overall, the detailed case studies enable me to reflect on how the territorial governance structure impacts inequality both from a static and dynamic perspective. I complement my argument on how decentralization impacts inequality with how the interactions in governance can also add to or detract from decentralization's effect on inequality. This work allows me to measure interactive governance by disaggregating it into its processes and outputs through looking at its

intergovernmental and non-governmental aspects, which brings a new applied method to understanding and measuring governance.

In my case studies, I demonstrate that Spain's asymmetric fiscal decentralization; its low shared-rule and low interactive governance are significantly associated with its high level of income inequality. France's symmetrical and centralized fiscal structure and its low decentralization are associated with its currently low inequality levels. Germany is a federal country, but its fiscal policies are strongly coordinated at the central level, which leads to low inequality levels. Sweden, as a unitary and a decentralized country, has high interactive governance and strong state coordination, which makes for a territorial governance structure conducive to lower income inequality.

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PREFACE

This dissertation has gone through various stages. I generated the idea for this topic in the first year of graduate school at an International Political Economy Seminar of Prof. David Bearce, and then I had a chance to polish in my third year at a very fruitful graduate seminar course of Prof. Despina Alexiadou, *Comparative Political Economy*. It was a very inspirational class and her encouragement for me to tackle this research idea and her valuable suggestions paved the way for this dissertation, which I am thankful for.

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1.0 INTRODUCTION: WHY INCOME INEQUALITY

Economic inequality leads to political inequality, and this political inequality then leads to rewriting the rules to increase the level of economic inequality even further, and so on. The result? Ever greater disillusionment with our democracy (Stiglitz 2015, p.149).

Without doubt, economic inequality is one of the most important phenomena of today's world. A concept that crosscuts many fields, economists, political scientists and sociologists and researchers in many different fields around the world are invested in illuminating the nature, the determinants and the consequences of this complex phenomenon called inequality. Economic inequality, which is most often measured with respect to the inequality of income, has important repercussions on economic growth, social justice, varying access to economic resources or on social movements, among others. It has also various political, social and economic determinants, which are usually challenging to disentangle. Economic inequality has fascinated political scientists and thinkers since Plato, Tocqueville and Madison, who have argued that "too much inequality" hinders democracy, while some others like Hayek and Friedman regard inequality as an inevitable result of political freedom and liberty (Beramendi and Anderson 2008). As Müller (1988) shows in his seminal work, high levels of income inequality are not compatible with the development of a stable democratic political system. Engerman and Sokoloff (2002) also show that in the Americas, initial inequality deters the development of democracy. Inequality has served both as a *dependent* and *independent* variable in social science literature.

Interest in bringing into light the causes of inequality has resurfaced since the 1960s and 1970s, and this upsurge in interest is usually attributed to the increasing inequality levels especially in the industrialized countries (Micklewright 2007; Kenworthy 2004; Kenworthy and Pontusson 2005). As the wage distribution widened in the 1980s in the UK and in the USA, researchers on income inequality started to be concerned with whether income inequality was a peril of these two countries, or whether it was prevalent in the industrialized world (Salverda, Nolan and Smeeding 2009; Gottschalk and Smeeding 1997).

Widening income gaps between the rich and the poor have become a global phenomenon in the recent decades, especially in the developed economies. A report published in December 2011 by the Organization for Economic Cooperation and Development (OECD) informs us that in the 2000s, the gap between rich and poor increased not only in countries with already high inequality levels but also in countries such as Germany, Denmark, and Sweden, known to be 'more egalitarian'. Since 1990, the wage gap between the full-time German workers earning the highest 10% and the lowest 10% salary has increased more than five times[1]. At a time when the world is attempting to recover from a global financial crisis by utilizing both centralized and decentralized types of governance, looking at the reasons and implications of income inequality calls for a new structural conceptualization, centering on the economic geographical patterns. The distributional repercussions of having distinct territorial governance structures have not been examined empirically, especially in the context of developed countries.

In this work, I ask the following question: What are the distributional effects of decentralization in developed countries? Decentralization, which can be found both in federal and in unitary states, is often advocated as a way to deliver better services to citizens. However,

[1] Thus, among developed economies in the world, Western Europe is an appropriate region to investigate the determinants of inequality. I follow this reasoning.

the actual effects of decentralization on people's well being is a relatively underexplored theme. This dissertation intends to answer this question by investigating the significance of the relationship between territorial governance structure of a country and/or its decentralization, the interactive nature of governance and an important economic outcome: income inequality. Using nested analysis - combining a large-N quantitative analysis and in-depth study of four Western European countries with different governance structures – namely Spain, Germany, France and Sweden, this dissertation aims to integrate interactive governance into the more conventional debates on fiscal decentralization and inequality.

1.1 WHY STUDY TERRITORIAL GOVERNANCE AND INCOME INEQUALITY: THE IMPORTANCE OF THE QUESTION

Governing always has a territorial dimension to it (Hague and Harrop 2004), since rulers need to extract resources from regions while keeping the willingness of the population to stay in their own sphere of influence, as exercised by voting in democracies. As Beramendi (2007) states, "*Discussions about the allocation of power across levels of government have been at the forefront of political analysis since the dawn of modernity*" (p. 752). In the literature, the differences in the organization of this territorial dimension are mainly analyzed within the dichotomy of federal and unitary states. Yet, not all types of federal and unitary states produce the same types of policy outcomes. In this dissertation, I apply a more refined approach to studies of federalism and assess how different types of decentralization impact income inequality in both unitary and federal countries. Several authors claim that the varying levels of decision-making autonomy of subnational units have important repercussions for the distribution of income in a country (Hooghe, Marks and Schakel 2008, 2010; Boix 2003, Beramendi 2007; Rodden 2004; Glaeser 2006, Hague and Harrop 2004). However, the causal mechanism and the directions of the mechanism have been underexplored, especially as far as empirical studies are concerned. There is no consensus in the literature on the causal paths between decentralization and redistribution. There is a gap in the literature concerning the causal mechanism that links these three components: Economic geography (namely territorial governance patterns), redistribution and income inequality. If redistribution, by default, targets economic distribution, and thus inequality; then how do territorial governance patterns, which shape redistributive politics, have an impact on inequality? This is the main gap addressed by this dissertation and these causal mechanisms will be explained in more detail in the theory section. This dissertation will explore how different types of decentralization, and especially fiscal decentralization to subnational units constrains the overall ability of the central government to exercise central fiscal policies to target inequality. It will also test whether the interactions of different governmental levels and social actors toward goals to tackle inequality (interactive governance) are associated with lower income inequality and whether interactive governance can offset the inequality inducing effects of decentralization.

1.2 THE ARGUMENT IN BRIEF

Specifically, I ask in what ways the structure of the government, or the allocation of authority across jurisdictions, can influence redistribution in a country. Does having more authoritative regions lead to more income inequality in a country? My main argument is that higher decentralization, especially in form of fiscal decentralization, inhibits the overall ability of the central government to exercise standardized central fiscal policies (redistributive and tax) that target inequality. Additionally, in a decentralized structure, intraregional differences in capacities of the regions can also lead to inconsistencies in redistribution and infrastructures, which would be more likely to create economic differences, such as inequality. However, if subnational units (e.g. regions) share the power in deciding what the central government 'redistributes', this would offset the impact of regional fiscal autonomy on increasing income inequality. Furthermore, if different governmental levels and social actors interact in policies that target inequality (interactive governance), this should be associated with lower income inequality levels in a country. Interactive governance can mitigate the effects of decentralization contributing to inequality.

1.3 PLAN OF THE DISSERTATION

The dissertation proceeds as follows: In the following chapter, I define the dependent variable and the key independent variables of this dissertation and present the research design and the methodology. This chapter also provides definitions and the operationalization of the terms I will be using in the quantitative and the qualitative analysis. The theoretical chapter follows the chapter with the definitions, and in that chapter I first expand on my argument between territorial governance and income inequality, followed by my argument on interactive governance and income inequality. In my discussion, I survey the literature on federalism and centralization/decentralization to inform my theory on the link between decentralization, regional authority and income inequality. I also include a brief review of the literature on territorial governance and income inequality. Then, I present my testable hypotheses. The chapter on research design and methodology explains in detail my typology and how my cases were selected.

Afterwards, I present my quantitative analysis, where I test my theory with data from 17 OECD countries in Europe between the years of 1960 and 2006, using a fixed effects model. In line with my theory, I find that countries that have more fiscal decentralization, that is, regions with high fiscal autonomy (self-rule) experience more income inequality, whereas those countries with regions that share the fiscal authority with the central government to a higher extent (shared-rule) experience less income inequality. This analysis is followed by the case studies of Spain, Germany, France and Sweden, as countries in my typology. In my conclusion, I summarize the findings of these four case studies to compare and contrast the findings and I put the findings into a general framework and present further avenues for research.

2.0 DEFINING THE VARIABLES, RESEARCH DESIGN AND METHODOLOGY

In this chapter, I define the independent and the dependent variables of this dissertation, followed by the research design and methodology.

2.1 DEFINING THE DEPENDENT VARIABLE: INCOME INEQUALITY

Establishing the link between the territorial governance structure of a country and an economic outcome, such as income inequality, requires an elaborate definition of the relevant concepts that will be used in this dissertation. This chapter first defines the dependent variable, **income inequality**, and the key independent variable used in this dissertation, **decentralization**, with its various dimensions.

2.1.1 Defining income inequality

In the quantitative and the qualitative analyses of this work, I take **income inequality** as my main **dependent variable**. Income inequality is measured with its various dimensions in the literature. In this section, I first look at these different measurements and definitions.

Income inequality is one of the most common measures of economic inequality. Economic inequality mostly concerns itself with the differences between accessing or controlling economic measures (Jenkins and Van Kerm 2009). In most literature, income inequality is measured with the *Gini* coefficient, which is usually reported on a scale of 0 to 100, and sometimes on a scale of 0 to 1, which has been named after *Corrado Gini*, the Italian statistician. The Gini coefficient uses the Lorenz curve, which is a graphical representation that plots cumulative income shares against cumulative population shares. The Gini coefficient indicates the ratio of the Lorenz curve and the perfect equality line to the whole area that remains below that line (Jenkins and van Kerm 2009). This means that the Gini score is actually converted to a single number (Atkinson 2015). A higher percentage (on a scale of 0 to 100) or the higher the ratio (on a scale of 0 to 1) indicates more inequality. There are other indices of income inequality, which is used in the case studies of this work, such as the income ratio of the 90^{th} percentile, which is the top of the income distribution to the income of the 10^{th} percentile (the bottom percentile), or the income ratio of the 90^{th} percentile to the 50^{th} percentile (P90:P50), or the income ratio of the 50^{th} percentile to the 10^{th} percentile (P50:P10) ratios. These indices allow us to understand the income distribution of people at different income levels of the population in relation to each other. When relevant and when there is available data, I will report some of these percentile scores in the case studies as well. Next, I turn to the important distinction between market and net income inequality.

2.1.2 Market (gross) vs. net (disposable) income inequality

In this work, I look at different measures of the Gini inequality, to take into account the impact of taxes and transfers. **Market (gross) income inequality** refers to the inequality before taxes and transfers, usually measured with household income inequality. The distinction of market income inequality and net income inequality is an important one, especially when explaining the importance of welfare state policies on income inequality. In this work, I mainly report measures of household **net (disposable) income inequality** of the countries to account for the different components of their welfare state.

Overall national market inequality is measured in many cases with respect to household net (disposable) income. Household net income is measured by adding the income of the persons in the household, their income from capital, private transfers and state transfers. Deducting taxes (federal/national and local) from this household gross income results in the household disposable (net) income (Atkinson 2015; Jenkins and Van Kerm 2009). This household income measure is usually referred to as inequality in net (post-tax, post-transfer) income. On the other hand, market inequality is the inequality level that is pre-tax and pre-transfers. In the case studies, I report both the market and the net income inequality measures to show the difference between the two levels. I use income inequality measures from the World Income Inequality Database (Solt 2016). In my theory, I am interested in how decentralization impacts the net income inequality since that measure incorporates the impact of the welfare state policies (which I argue are impacted by decentralization). Therefore, in my statistical study I report the net income inequality levels.

Another caveat with reporting the *Gini* inequality levels is that the value of public services and policies on income, such as unemployment policies, pensions or health care, is usually not accounted for with these scores and therefore leads to an omission (Atkinson 2015). Because of this omission, my case studies elaborate on how decentralization can impact such public policies, and therefore have an indirect impact on income inequality through these policies (which are not automatically accounted for by the *Gini* scores).

2.1.3 Defining regional inequality

While my theory centers on how the territorial governance structure will significantly impact the national inequality levels, the different redistributive practices can also be revealed by regional inequality measures when available. Regional inequality can also be considered as the variation in incomes among the subnational units, which are "horizontal inequalities" (Vanneman and Dubey 2013). In the case studies, I also look at **regional inequality** measures by presenting regional *Gini* inequality scores, purchasing power standards (PPS) of the reported regions as a percentage of the European Union (EU) average and/or regional Gross Domestic Product (GDP) figures to account for the variations in regional production. These measures are important in understanding whether the impact of decentralization on income inequality manifests itself with regional inequality, and/or overall national inequality levels.

2.2 DEFINING THE INDEPENDENT VARIABLES (1): DECENTRALIZATION

In this section, I foremost define my first independent variable, decentralization, before moving to my other independent variable, which is interactive governance. **Decentralization**, as a general concept, is defined as the allocation of different types of authority across territories and regions in a country. By definition, decentralization connotes the allocation of power away from the center (Schneider 2003). We can also think of decentralization as delegation of power to lower levels, but it is also distinct from it: The officials of the lower levels are responsible for those levels as different territorial jurisdictions, rather than just being the de-concentrated subordinates of the central government (Smith 1985). Decentralization is an important concept in social studies, as it has been shown to affect political participation, accountability, ethnic and territorial conflict, policy innovation, corruption, government spending, democratic stability, and human rights (Hooghe et al. 2010). One issue with research on decentralization is that 'what actually constitutes' decentralization shows variation in different sources (Falleti 2010). Decentralization might originate from the necessity and the willingness to allocate certain resources in a more efficient way. Falleti (2010) defines decentralization as the set of policies, electoral reforms, or constitutional reforms, which transfer responsibilities, resources or authority from higher to lower levels of government. One can also look at the individual origins of political decentralization. Following a rational-choice and a spatial model approach, some studies have assessed how individual preferences shape different types of policies. Cremer and Palfrey (1999) have devised a model where voters are assumed to be risk averse. Assuming that the main benefit of centralization is reducing variation in policy outcomes, they argue that voters with extreme policy preferences will prefer decentralized policy making, whereas moderate voters will ask for the opposite.

Decentralization is often discussed in terms of structural variables, such as federalism, fiscal autonomy, law-making prerogatives of subnational governments, or how much or what types of grants local governments get from the government (Agranoff 2010; Blume and Voigt 2011; Hooghe et al. 2008, 2010; Lane and Ersson 1999; Persson and Tabellini 2003). The study of decentralization as a concept has evolved over the years. In the 1970s and 1980s, decentralization was studied mostly with respect to how it related to the hierarchies in the government structure. Then, the concepts of political power sharing or liberalization started becoming the concern of decentralization studies. As of the 1990s, decentralization came to be understood also as a concept to indicate more inclusion and public participation (Shabbir

Cheema and Rondinelli 2007). Therefore, using Sartori's wording, decentralization is rich in its intention (Sartori 1970) with a high number of attributes and properties: with political, administrative, fiscal transfers of authority to lower levels of government. The multiple definitions and usages of the term 'decentralization' prove the fact that decentralization is approached by various intellectual traditions (Wallis 1991). As Hooghe, Marks, Schakel, Niedzwiecki, Chapman Osterkatz, Shair-Rosenfeld (2016) argue, a three-fold look at decentralization proves to be enlightening when examining the impact of decentralization on different outcomes, including economic ones. In this work, I follow this reasoning and examine all three dimensions of decentralization commonly found in the literature: **Political, administrative** and **fiscal**.

Decentralization is largely, but not necessarily found in federal countries. For this reason, although I do not specifically focus on the impact of the federal vs. unitary distinction on inequality in this work, my theory is informed by the literature on the impact of federalism on economic outcomes, as the next chapter will explicate. In my typology, I include two federal states - Germany and (de facto federal) Spain – and two unitary states – Sweden and France - due to this point of departure. Also, understanding federalism is illuminating for grasping different types of decentralization. The terms "federation" and "decentralization" differentiate between different levels of decision-making. Federation is a constitutional-level feature, whereas the term decentralization connotes a policy choice (Blume and Voigt 2011; Smith 1985). The allocation of powers among different levels of government is usually distinguished with the distinction of federal/unitary regimes, which indicates the formal constitutional arrangements. A federal constitution stipulates how the power between the subnational units and the center will be allocated and what the "exclusive prerogatives" of each subnational unit are (Tarr 2005). Also, an important distinguishing element is that federal systems have safeguards to prevent changes in the power allocation between different governmental levels (Hueglin 2013). Also, in federal systems regional representatives usually engage in one type of institutionalized negotiations with the central government, rather than asymmetric type of relationship (Riker 1964). Therefore, a constitutionally federal system goes beyond the types of decentralization that can be found in unitary systems. Decentralization levels could be reversed without changing the constitution.

Generally, a constitutionally federal country is one with strong constituent subnational units, which can enact - to different extents – their own policies, with a certain degree of influence on certain authority. As Elazar (1987) explains, "*Federal principles are concerned with the combination of self-rule and shared rule… Federalism has to do with the need of people and polities to unite for common purposes yet remain separate to preserve their respective integrities*". The interactions of the subnational units with the central government are analyzed with this dichotomy, which implies that the constituent units are both self-standing and they also have to share the rule with some other subnational units, as well as with the central government. The balance between this self-rule and shared-rule matters for policy choices – and policies that matter for inequality as well, as I will argue in this work. Those policy choices that matter for inequality are better tackled with examining varying levels of decentralization. As this dissertation will demonstrate, constitutionally unitary countries, such as France or Sweden, have high levels of – administrative – decentralization, which matters especially in terms of policy implementation, service delivery of social policies, or also in determining some regional policies.

Again, the different variations of federalism are crucial in understanding how decentralization would function differently. According to Lijphart (2012), federalism is usually described as a spatial or territorial division of power in which the component units are geographically defined. He presents the following typology of countries: *1) federal and decentralized 2) federal and centralized 3) semi-federal 4) unitary and decentralized 5) unitary and centralized* countries.[2] Biela, Hennl and Kaiser (2013) also use the same typology, plotting the federalism indicators (federal and unitary) against decentralization indicators for testing the significance of these variables on policy implementation and performance. As Hueglin (2013) and Scharpf (2008) delineate, if the exclusive policy powers are separated and are allocated to different levels of government, this would be the case of dual or divided federalism, such as that in the US. On the other hand, if within one policy area, different levels share the power powers, we can call it *integrated*, *functional* or *cooperative* federalism, which is seen in the case of Germany and impact the functioning of decentralization in the country. This "functional" type of federalism, is also more related to what I take as "interactive governance" in the later parts of this definition chapter. However, interactive governance is not confined to federal states. The very definition of federalism can be regarded as the "*a set of territorially based actors with ideas and interests who vary greatly in number and heterogeneity*", "*a set of intergovernmental fiscal transfer arrangements*" and a "*set of informal arrangements-both vertical and horizontal between governments*" (Obinger, Castles and Leibfried 2005, p.9). Their argument on the heterogeneity and the intergovernmental transfers - both formal and informal – provide another foundation for me to elaborate on this issue as it pertains to decentralization.

Federal constitutional arrangements progress after they are formed and they are argued to "represent the political evolution of their political systems" (Peters 2012). As Beramendi (2012)

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[2] For example, in Denmark, a large percent of the public money, which corresponds to 60 percent of all government spending is spent at the national level, pointing out to *fiscal decentralization* or *fiscal federalism* (Hallerberg 2006). However, Danish mayors and the subnational governments do not have much authority in how these funds are raised or spent. Therefore, measures of fiscal decentralization do not necessarily match political decentralization levels.

notes, and as the case studies will show, Spain was designed as a "centripetal" political union and the main goal of the political system was to limit the influence of regional and identity based parties before the democratization. However, after the initial decision to decentralize the major public services with democratization, such as health, education, and infrastructure building, political actors at subnational levels gradually gained more power and started asking for more decentralization. Thus, we can argue that the extent of decentralization is also related to political dynamics and the interaction of different actors with different resources. Although decentralization seeks to produce structural changes, these changes are not implemented automatically and political dynamics and power sharing may accelerate or slow down decentralization processes. The case studies will show the processes of decentralization from a more detailed perspective, and their – mainly distributional and redistributional - consequences.

2.2.1 Political decentralization

From a general perspective, political decentralization can be viewed as the extent to which central governments allow subnational units to take part in the political governance of the country (Schneider 2003). Yet, this perspective does not necessarily distinguish between the self-rule and the shared-rule of the subnational units.

Why does political decentralization exist? Discussions on decentralized governance exist in many plural democracies, for example with the Catalonia example of Spain, or the Scotland example of the United Kingdom. In line with this literature, Béland and Lecours (2007) show that nationalist demands in Québec and Flanders represent a powerful force for the decentralization of social policy since it seeks to make the national community congruent with the community of redistribution. Decentralization has been advocated in countries with deep ethnic tensions as a potential constitutional solution aiming to reduce conflict, build peace, and protect the interests of marginalized communities (Norris 2008). Consociational theory of Lijphart (1968) contends that federalism would be superior to a unitary state, if crosscutting divisions are created by the governmental structure. Lipset (1963) similarly argues that federalism can serve democracy well "b*ecause it increases the opportunity for multiple sources of cleavage by adding regional interests and values to the others which crosscut social structure. Democracy needs cleavage within linguistic or religious groups, not between them*." In a nutshell, federalism or decentralization can appease socio-political tensions and avoid conflicts between ethnic or religious groups.

Hooghe et al. (2016) consider the most distinguishing element of political decentralization as the subnational units having direct or indirect elections to office, and the roles of regional assemblies and executives in policy making. Again, the self-rule and the shared-rule elements of decentralization should be distinguished in this case. Whether regional governments can operate without central state control, or whether they can control their own policies can all be regarded as important elements of political decentralization. The statistical study and the case studies will elaborate on political decentralization further, looking at both the self-rule and the shared-rule components. My argument on decentralization and inequality goes through the channel of the redistributive welfare state, and the fiscal type of decentralization more explicitly affects redistributive policies. However, political decentralization especially impacts how these policies are made, and therefore is an important component of my argument.

2.2.2 Administrative decentralization

Administrative decentralization comprises the politics of transferring social services to subnational governments, (Falleti 2005, 2010; Norris 2008) or where authority to carry out these services is passed from the government to an appointed body, such as a UK Urban Development Corporation (Pollitt and Bouckaert 2004). In general, administrative decentralization measures how much delivery or implementation power the non-central government entities have (Schneider 2003). Hooghe et al. (2016) define administrative decentralization as the power of subnational governments to create goals and administer policies. Political and administrative decentralization are sometimes used synonymously, but administrative decentralization would also differ from political decentralization, since the latter could define a larger a set of attributes, with electoral and constitutional reforms that devolve political authority to elected subnational authorities. While I do not use administrative decentralization by itself as an independent variable in a hypothesis, some of the measures of decentralization that I will use to delineate regional authority include notions of administrative decentralization as well. Therefore, administrative decentralization can be embedded in political decentralization, and vice-versa. For example, how much the subnational government can veto the policies of the central government could fit under the categorization of administrative decentralization. Again, this concept can be examined both with respect to its self and shared rule aspects, which I will elaborate on in the next stages of this work.

2.2.3 Fiscal decentralization

The fiscal type of decentralization is one of the most relevant components of decentralization that plays a key role in the causal mechanism of the theory of the dissertation. Generally speaking, fiscal decentralization refers to the level of fiscal power the central level grants to the subnational or non-central government units (Schneider 2003). This fiscal power is concerned with both the spending and the generating of revenues by the subnational units. Beramendi (2012) considers a decentralized fiscal system as one where regions take care of interpersonal redistribution and where there is not much regional redistribution. In this case, a centralized fiscal system is where the prerogatives for taxes and transfers mainly fall on the central government. However, one should approach this dichotomy with precaution, as both of them could be at play in decentralized systems.

More exhaustively, fiscal decentralization could be measured with respect to the taxation autonomy of the regions (self-rule), or how subnational units co-decide with the central government on determining the tax bases and rates or how much borrowing autonomy subnational units have (shared-rule) (Hooghe et al. 2016). For example, in one of the cases of the dissertation, Germany, the regional governments gave away their fiscal autonomy for more shared fiscal control in 1966. This means that in terms of fiscal decentralization in self-rule, their scores have decreased, but in terms of shared-rule, their fiscal decentralization scores have increased after this point. In my case studies, I will specify both the revenue spending and the revenue generating side of fiscal decentralization in self-rule and shared-rule. In the theory section, I explain how the literature on fiscal federalism informs our understanding of fiscal decentralization in general, and how that contributes to the causal mechanism of the theory. According to Oates (1972), a pioneer scholar of fiscal federalism, federalism represents the compromise between unitary government and extreme decentralization, in the sense that each level of government performs what it can do best. The fiscal federalism literature establishes one of the key moving parts of the theory as it focuses on taxing and the redistributive aspects of federalism.

2.3 DEFINING THE INDEPENDENT VARIABLES (2): INTERACTIVE GOVERNANCE AND THE INTERACTIVE GOVERNANCE INDEX

In this work, my second hypothesis is concerned with how interactions in governance impact income inequality, against the backdrop of the centralized or decentralized structures. Interactions in governance can have a significant impact on both cross-regional and national disparities, and both in unitary or federal and/or centralized or decentralized systems. I use the term "interactive governance", as defined by Torfing, Peters, Pierre and Sorensen (2012): It refers to the "*complex process through which a plurality of social and political actors with diverging interests interact in order to formulate, promote, and achieve common objectives by means of mobilizing, exchanging, and deploying a range of ideas, rules and resources"* (p. 14). In the quantitative chapter, I operationalize interactive governance with the shared-rule elements of regional authority, such as law making, executive control, fiscal control or constitutional reform, using the indices of Hooghe et al. (2010).

2.3.1 Defining interactive governance

In the case studies, I operationalize interactive governance with the following two aspects:

1) Intergovernmental relations as pertains to policies related to inequality

I study whether there are clear and observed institutional relationships between each subnational government and the central government. For example, I look at the prevalence of various intergovernmental meetings and their importance in policies that matter for income inequality, especially concerning fiscal matters. By looking at intergovernmental relations, I am able to tease out the existing vertical and horizontal coordination mechanisms in these countries, and the steering role of the central government in welfare state related policies and decisions. Intergovernmental relations are an important part of federalism and decentralization studies (Agranoff 2004; Smith 1985; Watts 1998). With this aspect of interactive governance, I look at intergovernmental relations as a type of both horizontal and the vertical types of governance with a "strictly institutional perspective" (Torfing et al. 2012) rather than using it from a perspective of multi-level governance, where the number of levels and the participants would be more loosely defined. Furthermore, we can think about the intergovernmental aspect of interactive governance with respect to policy networks between the public sector and policy networks, yet we would need to know the content of these networks before knowing their impacts on policy making. In the institutionalization of interactive governance (Torfing et al. 2012), policy networks can be crucial actors that are created in order to find redistributive solutions. Therefore, the institutionalization of governance provides the connection between the two components of my argument on interactive governance: "*Although members of networks may share some common interests, that is often insufficient to guarantee the formation of an effective and enduring network. If, however, there are gains to be made from institutionalizing the structures* *and creating effective networks, then the network may persist and may even begin to have meaning for the participants*" (Torfing et al. 2012, p. 118).

2) The roles of non-state actors (social actors) on policies related to inequality

As far as the second part is concerned, the interactive governance component requires an assessment about the inclusion of non-state actors in the process. This is because the definition of interactive governance does not only concern state actors, but a "plurality" of actors that can impact policy-making. The relationships between the government and the social actors (e.g. trade unions) vary in their influence on economic outcomes, especially in terms of wage bargaining or other welfare state policies related to inequality, such as unemployment policies. Wage bargaining institutions themselves are explanatory of pay inequality (Beramendi and Rueda 2014), which impacts the overall national inequality levels. Therefore, examining these interactions are illuminating for understanding the nature of interactive governance. Interactive governance connotes interactions through partnerships and networks that share an objective. Therefore, an understanding of whether subnational levels have similar commitments to equitable redistribution goals would be crucial.

In the detailed case studies, I study the patterns of the actors at different levels in terms of their influence on redistributive policies, which in turn will have repercussions on income inequality. To this end, when using interactive governance, I ask the following questions: Do 1) the interactions between the officials of central government and the subnational units, 2) the interactions between officials of various subnational units and the interest groups, and 3) interest groups in general, play a significant role in redistributive and social policies that impact income inequality? And how do decentralization or centralization affect these interactions? I use scores of Visser (2015) from the *Data Base on Institutional Characteristics of Trade Unions, Wage*

Setting, State Intervention and Social Pacts, 1960-2014 to look at the wage setting/bargaining coordination levels of the countries that I examine. This index is reflective of both the centralization and the effectiveness of wage setting and bargaining.

My analysis of this second (non-state actors) component of interactive governance will also include an assessment of how corporatist the cases I am analyzing are in general. An understanding of corporatism is crucial for testing interactive governance on income inequality. To recap this concept, a commonly cited definition by Schmitter (1974) is as follows:

> "Corporatism can be defined as a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, noncompetitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports".

While corporatism does not necessarily always denote interactive governance, the way the social actors are institutionally embedded in the policy-making mechanism has more similarities to interactive governance than pluralism. In the interactive governance paradigm, the interactive policy process can be related to a corporatist policy-making structure especially because of its contribution to easier implementation of policies. As Torfing et al. (2012) explain, the question of how certain interest groups have privileged access and contribution to policy making, using the Schmitter (1974) definitions, has shifted more towards how interest groups can contribute to public value through interactions. Thus, looking at whether the countries are corporatist or not provides a good starting point in understanding whether interest groups are influential in wage bargaining or bargaining in social policies that matter. Both in pluralist and corporatist systems, the political institutions fuse with the organized interests; therefore the inclusion of the pluralist/corporatist structure will be revealing for understanding how inequality related policies are made, especially in the case studies of this work.

2.3.2 Interactive Governance Index: a tool for measurement

The table below showcases the index I generated to measure interactive governance, building on Torfing et al. (2012)'s concept with my own elaboration. I look at both *processes* in interactive governance and *outcomes* of interactive governance (in this case redistributive policies and ensuing income inequality) with this index. At the end of each case study, I will present the *Interactive Governance Index* for that country.

Table 1. Interactive Governance Index - Sample Table

Processes	0 Low	1 Medium	2 High
Identifiable goals – concerning equality in tax capacities and social policy delivery			
Vertical: Clear and observed rules of relationships between each subnational government and the central government			
Vertical interactions (mutual contingencies and interdependencies between different levels)			
Horizontal interactions: Central government's capacity to coordinate among its departments & interactions among different layers			
Relying on social partners and compromise			
Harmonized and integrated policies at various levels			
Outputs			
Goal attainment and distributional effects			
Institutionalization and dissemination of revenue collection with equalizing effects			
Systemic approaches to governing at different levels			

2.4 RESEARCH DESIGN, CASES AND METHODOLOGY

The analysis of this work will be conducted in two stages. First I conduct a quantitative analysis, using the Regional Authority Index of Hooghe et al. (2010) in order to test the impact of both the self-rule and the shared-rule of decentralization. I will base my research on the mixed-method *nested analysis* strategy proposed by Lieberman (2005). In nested analysis, the researcher starts with the quantitative models, and then continues with the case studies, either for model building or model testing. I use my case studies to apply my theory and to disentangle the causal mechanism between economic geography, interactions in governance an income inequality. In my case studies, I will operationalize decentralization by looking at its self-rule and shared-rule elements in political, administrative and fiscal aspects. While the quantitative chapter takes shared-rule as a proxy for more interactive governance, the discussion of ‘interactive governance’ in the case studies will be conducted from a qualitative perspective.

Here is the typology of the four countries that will be examined in the case study chapters:

Table 2. Typology of the Cases of the Dissertation

Spain *(De facto) federal state (Officially unitary)* Low interactive governance	**Germany** *Federal state* High interactive governance
France *Unitary state* Low interactive governance	**Sweden** *Unitary state* High interactive governance

I take two officially unitary states, *France* and *Sweden*, one officially federal state, *Germany*, and one officially unitary state with some federal characteristics, *Spain*. The case studies will analyze the different types of decentralization and the interactions among the subnational governments and the central government, and how these impact the fiscal and social policies relevant for inequality. The case studies will also explain why these countries have either *high interactive* or *low interactive* governance, and how the *interactive governance* or its low levels, matters for income distribution and economic inequality. The constitutional structure, often analyzed using the dichotomy of federal and unitary states, serves as the starting point in the case studies for understanding how the competences are officially shared between different levels of government. However, the case studies examine in more detail how political, administrative and fiscal decentralization also co-vary with the official competence sharing between different levels in a country. That is, both in unitary and federal states, varying levels of decentralization can be found, which in turn impacts redistribution, distribution of resources and services, fiscal and social policies and relatedly, income distribution in these states.

These particular countries have been chosen 'purposively', (Peters 2013) for their theoretical relevance as 'crucial' cases to understand the link between centralization/decentralization, interactive governance and income inequality. For the purposes of this dissertation, Spain and Germany are both classified as federal states (Spain as *de facto* federal) but where they diverge in this classification is significant in understanding variation in their redistributive practices. Spain's tax and redistributive practices as well as overall intergovernmental relations are closely associated with its territorial governance structure. For example, Germany differs in the strength of the central government in steering the process of redistribution among regions and its role in mediating the relationship between the state and the non-state actors on redistributive matters. Is this related to income inequality? For this reason, looking at these two cases will be revealing to understand both the static and the dynamic impact of decentralization, as well as interactive governance. Sweden and France are both unitary countries with centralized features, but Sweden boasts more decentralized implementation, as well as more interactive governance than France. Do the different natures of their unitary territorial governance structures, as well as differing interactive governance structures offer compelling evidence for their differences in their inequality? I aim to answer this question by including these case studies. Furthermore, as Germany and Sweden display lower inequality, can we connect this to the combined effect of their territorial structures and their high interactive governance levels? Again, for the purposes of a typology, I use the crude dichotomy of federal vs. unitary, but the case studies will tease out the applications of the self-rule and shared-rule elements of territorial governance for both unitary and federal countries.

Figure 1 below shows the trend of inequality in these four countries from 2003 to 2014. While there is an overall increasing trend in inequality, the countries in the non-interactive category, Spain and France show a more visible upward trend. The last few years in Spain witnessed higher inequality gradually. In France, there is a big jump from 2007 to 2008 about 4 percentage points, but it is important to highlight the relatively steady income inequality rate in the early years of the 2000s. While in Sweden, the income inequality rate shows a slight decrease, it is still the country with the lowest income inequality among these four countries. The two federal countries are more unequal in general according to these figures, yet Germany, the state that I categorize as highly interactive, has lower inequality levels than Spain. Germany’s inequality shows fluctuations in the 2000s, going over 30 (out of 100) at some points. I will analyze all of these trends in detail in the case studies.

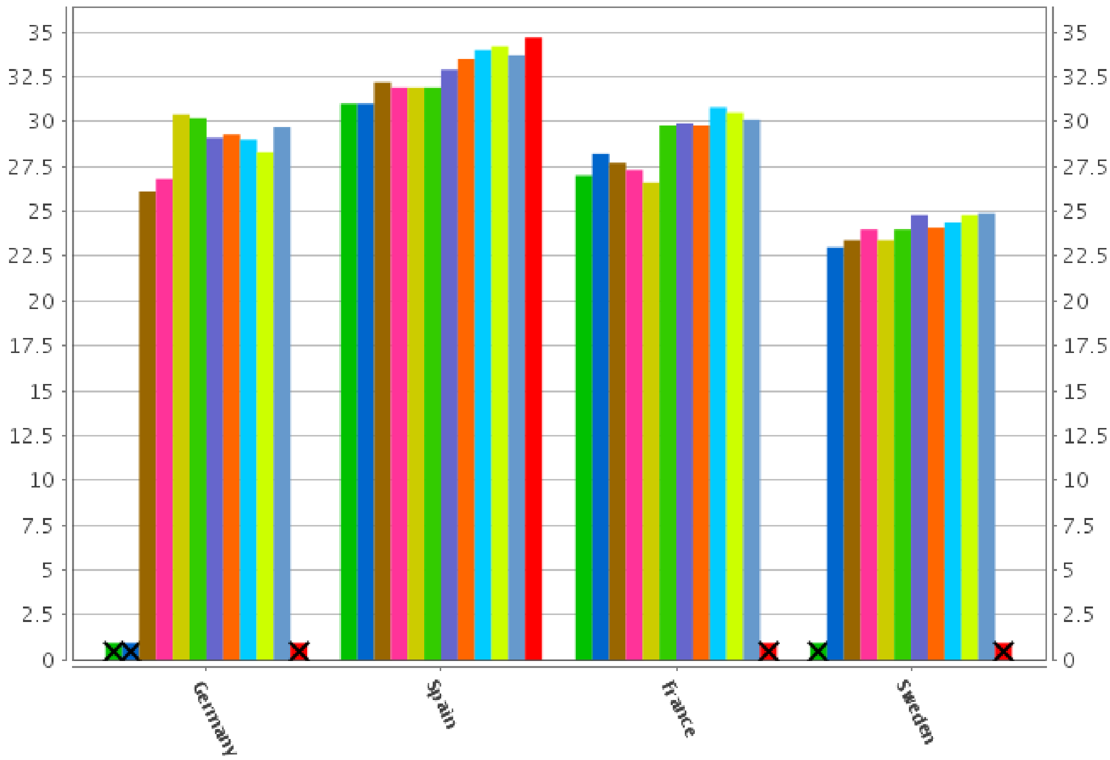

Figure 1. Inequality Trends in the Four Cases, 2003 to 2014

Source: OECD (2015)

These case studies aim to demonstrate the different ways in which the territorial and interactive governance impact income inequality by affecting the distribution of resources and the creation of fiscal and social policies related to income inequality. To that end, I make use of interview data gathered in fieldwork and primary and secondary sources, such as constitutional texts and press releases. Throughout the discussions, one subnational unit (also referred to as regions in some cases) in each country is highlighted as an example to explain the central – subnational level relations. This will also serve the purpose of analogical reasoning among the unitary vs. federal and the interactive vs. non-interactive states especially concerning the fiscal intergovernmental relations and the channels of policy making.[3] The four sample subnational units that I will highlight in my interview findings are: the autonomous community – *comunidad autónoma* of **Catalonia** (Spain), the state – *Land* - of **North-Rhein-Westphalia** (Germany), the county - *län* - of **Västra Götaland** (Sweden) and the *region* – of **Brittany** (France).

The chapters consist of the following general structure: 1) *background:* the official constitutional setup and the sharing of competences between different levels of government and how *political* decentralization has progressed/retreated over the years, as well as a general look at the overall trends of inequality in the country, 2) an assessment of the *fiscal and administrative decentralization*, 3) the welfare states *linking it to inequality*: an examination of tax policies and equalization and redistributive practices (and some other social policies in the country that are affected by decentralization, 4) interactive governance: a) an analysis of the intergovernmental *channels* and *arenas* through which the subnational units and the central government interact in the *formulation* and the *implementation* of the main social policies/ issues that matter for inequality, b) the importance of **vertical** and **horizontal** coordination practices between different governmental levels and relevant non-state actors, c) the role of non-state actors, 5) tying it all together: an '*interactive governance'* score card for the countries, based on the abovementioned discussion. This last subsection in each chapter aims at devising

[3] Within intergovernmental relations, I underline fiscal intergovernmental relations, as quantitative and qualitative preliminary analyses determined that fiscal regional authority was the most significant type of regional authority for differences in inequality.

an index for assessing the impact of ‘interactive governance’ on a certain dependent variable, and in this case, income distribution and economic inequalities at national and regional levels in the specific countries examined. One of the contributions of this dissertation is the creation of an assessable interactive governance index that could be applied to other socioeconomic indicators in addition to income inequality in future research.

3.0 THEORY: HOW DO DECENTRALIZATION AND INTERACTIVE GOVERNANCE IMPACT INCOME INEQUALITY?

In this theoretical chapter, I explain why I expect **decentralization** (independent variable) to matter on economic outcomes, and specifically on **income inequality** (dependent variable). First, I explain the key component of my theoretical argument: the causal mechanism that links territorial governance (decentralization) and income inequality through the channel of the welfare state. The welfare state, by definition, engages in taxation and spending, and therefore connotes redistribution, but not all welfare states have the same commitment to equality (Esping-Andersen and Myles 2009). With that in mind, I explain the importance of the territorial governance (decentralization) on income inequality, by elaborating on the arguments that touch upon the welfare state policies in different ways.

I dissect the broad concept of territorial governance by touching upon its following elements: *political*, *fiscal or administrative decentralization*. These elements are informed by concepts and theories on federalism, and especially *fiscal federalism*. Some political structures are more inequality *inducing* than inequality *reducing,* mainly due to public policies arising from the territorial governance structure (Linz and Stepan 2000), yet there is no real consensus in the literature on the reasons for this induction or reduction. This dissertation aims to contribute to the further understanding of how the territorial governance structure of a country impacts income inequality due to its political, administrative or fiscal decentralization, and how the territorial governance structure results in public policies– fiscal or social - that might have a significant influence on income inequality. There is a gap in the literature concerning the causal mechanism that links these three components: Economic geography (namely territorial governance/decentralization), redistribution and income inequality. If redistribution, by default, targets economic distribution, and thus inequality; then how do territorial governance patterns, which shape redistributive politics, have an impact on inequality? My approach in this work is driven by a goal to address this gap with my quantitative and qualitative study.

Second, this theoretical chapter explains the link between *interactive governance* and *income inequality*. I describe why I expect more interactive governance to be significantly associated with less income inequality. As stated in my chapter on the definitions of this dissertation, interactions in governance can have a significant impact on both cross-regional and national disparities, and both in unitary or federal and/or centralized or decentralized systems.

With these components, I lay out the theory of the dissertation. I expect decentralization – and especially fiscal decentralization – to be associated with more income inequality. Here, I refer to the self-rule components of decentralization. On the other hand, in both centralized and decentralized countries, I expect more shared rule – and especially fiscal rule - between the central government and the subnational units to be associated with less income inequality. I test the impact of shared rule on income inequality by looking at various dimensions that make up the shared-rule aspect of decentralization, and then also by using the concept of *interactive governance*, which I associate with higher shared-rule. I associate shared-rule with interactive governance due to the coming together of various actors at different territorial levels. Interactive governance might work to offset the inequality inducing impact of - fiscal, political or administrative- decentralization in a country. In sum, my aim in this chapter is to disentangle the following causal mechanisms, which I test in my statistical study and case studies.

1) Fiscal
Political decentralization
Administrative
(self-rule)
→ More Income Inequality

2) Interactive Governance
(Shared – rule)
→ Less income inequality

3) Fiscal
Political decentralization
Administrative
X
Interactive Governance
→ Less Income Inequality

4) Fiscal
Political decentralization
Administrative
X
Low Interactive Governance
→ More Income Inequality

To test these arguments, I first look at the general significance of federalism/decentralization on redistribution and then more specifically focus on the impact of **fiscal decentralization** in my case studies. The main independent variables of the dissertation are decentralization – (and its different types) – and interactive governance. However, foremost, the literature analyzes the differences in territorial governance through the concept of federalism. Yet, since not all types of federal and unitary states produce the same type of policy outcomes, looking at decentralization, rather than the unitary vs. federal states dichotomy allows a more refined application of the theory. Yet, I still start with the dichotomy between federal and unitary states due to the vast literature of federalism that informs my theory.

While higher levels of devolution to subnational units or more decentralization are mostly found in federal states, some unitary states also have subnational regions that have high levels of either self or shared rule. For example, some officially unitary countries, such as Italy or Spain (*de facto* federal), have regions with higher degrees of authority than many officially federal countries (Hooghe et al. 2010). In order provide the foundation for the basis of my theory on decentralization and income inequality, I first elaborate on how federalism is expected to impact inequality in general.

3.1 THE CAUSAL MECHANISMS OF THE THEORY

3.1.1 Federalism, decentralization and inequality: the causal mechanism

There is no escape from a compelling truth: federalism and equality of results cannot co-exist. (Wildavsky 1984, p. 68)

In the literature, a territorial analysis of a political structure first starts with the constitutional distinction of federal or unitary states, which has also guided my typology. Federalism attempts to balance joint action and self-government for relevant purposes of decision-making (Watts 1998). As explained earlier, federalism offers both the amalgamation of the preferences of citizens in different jurisdiction for joint action (shared-rule), as well as self-government (self-rule) (Elazar 1987; Watts 1998).

The lack of scholarly consensus on the impact of federalism on income inequality allows us to examine this link through different perspectives. We know that an important and distinguishing factor of federal systems from unitary ones is their possession of strong constituent units that can enact some of their own public policies and even influence the central authority to a varying degree (Hague and Harrop 2004). A peril of federalism is argued to be its inadequacy to sustain a good level of distribution due to the devolution of certain resources to the regions (Boix 2003). Unitary systems have more ‘unified’ policy control, and federalism produces “multiple equilibria with divided government between the two layers” (Dixit and Londegran 1998, p. 153). The understanding that federalism is associated with inequality is primarily related to the argument that federalism can result in different distributive and redistributive practices in a country, leading to varying economic outcomes throughout (Boix 2003; Wildavsky 1984; Rodden 2006; Treisman 2007). Federalism enables extra veto points that can block ‘nationwide distributive endeavors” and “large redistributive coalitions” (Beramendi 2012). Thus, the discrepancies in distribution among the regions can be regarded as an impact of the territorial governance structure; which can also give rise to discrepancies in redistributive practices.

There are relatively scarce studies and also conflicting results on the link between federalism and economic indicators (Castles 2000). Several studies look at the impact of federalism on various economic outcomes, some of which are relevant before my discussion of the impact of territorial governance on income inequality. For example, Wibbels (2000) finds that federal institutional arrangements do have a significant impact on the economic policy performance of states, and it hinders the capability of states to promote economic reforms against fragility, volatility and crisis. This argument is based on the understanding that subnational units do not have the same incentives to carry out the reforms as the central government, and this situation also hinders the capability of the central level to undertake economic reforms. Federalism is found to be associated with lower unemployment (Crepaz 1996), and lower inflation rates (Lancaster and Hicks 2000). As Biela et al. (2013) state, studies do not cohesively answer the question of how federalism actually matters. Furthermore, as specified in the previous chapter, there is ambiguity in terms of how federalism and decentralization are taken in different contexts, which contribute to this vagueness. As Sorens (2014) shows with his study on 15 OECD countries, economic self-rule (fiscal federalism) helps close the gap between poorer and richer regions, and equalization programs have not been found to be crucial for regional convergence. However, the author approaches this finding with caution. Another important study is by Rodden (2004), which shows that federalism is a negative factor for the growth of redistribution; but the empirical support for this argument is limited to 15 OECD countries, where only a crude federalism dummy was used.

Federalism and decentralization are distinct but also related concepts, as specified in the chapter on definitions. According to Biela et al. (2013) "federalism affects the way political decisions are taken, decentralization influences the implementation of policies". This distinct is explanatory but also remains perfunctory. However, if we consider the self and shared rule aspects of decentralization separately, both in unitary and federal systems, this ambiguity can be avoided to a considerable extent. For this reason, I consider the three aspects of decentralization as the key variables in my argument, while taking into account the constitutional structure.

Every federation is involved with some level of intergovernmental redistribution in order to correct the financial imbalances that might occur among different subnational levels (Watts 1998). Again, while it is important to consider the type of welfare state for predicting how redistributive it will be among its regions, it is not only the universal type of welfare states, or those with large welfare states that engage in intergovernmental transfers. These types of intergovernmental transfers do not just occur in federal but also in unitary systems. To better explain the relationship between fiscal intergovernmental relations and federalism, I now explore the literature of fiscal federalism to provide a better basis for my general argument on decentralization and inequality. The starting point of fiscal federalism is constitutionally federal systems, but the arguments are also applicable to unitary and decentralized systems that engage in intergovernmental transfers as well. Then, I turn to the explanation of how the territorial governance structure is associated with income inequality through the channel of taxing and redistributive policies, and other welfare state policies.

3.1.2 Fiscal federalism, fiscal decentralization and inequality

The fiscal federalism literature establishes one of the key moving parts of the theory of this work, as it focuses on taxing and the redistributive aspects of federalism. In all federal systems, fiscal decentralization necessitates the combination of meeting localized need and making sure that national standards are met (Boadway 2007). Fiscal federalism can sometimes crudely be equated with regional economic self-rule (Sorens 2012). More specifically, we can think of fiscal federalism with the following features: When subnational units decide on their own economic policies, when they fund their own spending with autonomous revenues, when there is a common market, and when this is institutionalized (Sorens 2010). One reason why I focus on decentralization in the actual analysis, but review the literature on fiscal federalism instead is because of the rich theoretical contribution of this field to studies on territorial governance. Also, fiscal federalism principles can be seen in both unitary and federal systems. As Sorens

(2010) argues, these fiscal federalism instruments connote the self-rule element of decentralization, which is the opposite of shared-rule elements of federalism or decentralization of Hooghe et al. (2008, 2010, 2016).

There are two competing views on whether fiscal federalism can address cross-jurisdictional economic discrepancies. First, some welfare economists such as Gramlich (1973, 1987) and Oates (1972) argue that federalism can deal with different local preferences and cross-jurisdictional externalities in a more effective and efficient way. Another advocating view of federalism comes from public choice theorists who also view federalism as an enabling factor for different levels of government to extract returns in a strategic way (Qian and Weingast 1997). For example, following public choice theorists, Ostrom (1973) argues federal countries can better implement the decentralized public goods and services provision.

As the pioneer scholar of fiscal federalism, Oates (1972) argues that, it is difficult for the local governments to meet the economic responsibilities and to stabilize their economies, to provide the necessary levels of services and - most importantly for this work – to achieve the most equitable distribution of income - if there is no fiscal federalism. Nevertheless, centralized governments are presumed to be more capable of preventing diversity of public goods (Sorens 2010). As Oates (1972) suggests, “within the highly decentralized fiscal system, local governments working independently to achieve differing redistributional objectives are likely to run into real trouble” if some jurisdictions enact different tax programs, leading to interjurisdictional mobility flows (p.7). Therefore, systems that are highly decentralized from a fiscal perspective, in both unitary and federal systems might be susceptible to this. On the other hand, a unitary government may be “insensitive to the preferences among the residents of the different communities” (Oates 1977). While the decentralization theorem within fiscal federalism focuses mainly on efficiency – which is not the main focus of the work - , it still raises the point of how it will impact equity, and thus, provides a good basis for understanding the link between territorial governance and income inequality. As Oates (1977) states,

> "*The spirit of the unitary solution to the provision of the public service would be to ensure a uniform level of the service over both communities (two jurisdictions). However, it is easy to see that in economic terms this will generally be inefficient. If the demands in the two communities for the public service differ (and if there are no economies of scale from centralized provision the service), then we can increase welfare by diversifying outputs in the two communities in accordance with local demands*" (p.6).

The main point to bear in mind concerning Oates' view (1972) is that a decentralized and a centralized system are presented as two extreme sides. Federalism represents the compromise between unitary government and extreme decentralization in this logic. A federal system is presented as the best compromise between uniformity/equity and efficiency: "*From an economic standpoint, the obvious attraction of the federal form of government is that it combines the strength of unitary government with those of decentralization*" (p. 14). However, this claim does not distinguish between how the self and the shared rule of decentralization would impact diversity differently. Therefore, going back to Sorens (2010), distinguishing between various dimensions of decentralization is more appropriate to test the impact of territorial governance on income inequality. In a similar vein, interactions between federalism and decentralization have been studied in order to find the impact of this interaction on policy performance in general (Biela et al. 2013). The authors argue that if there were low subnational fiscal autonomy in federal countries, then decentralization would not have a negative impact on policy performance.

In general, for multi-tiered governments, the fiscal indiscipline between the subnational units is a concern. Rodden (2002) shows that central governments cannot commit to the co-financing needs of the subnational units if they are constitutionally and politically constrained. If there are no centrally mandated redistributive policies, inequality across regions might increase

(Qian and Weingast 1997; Rose-Ackerman and Rodden 1997). This constitutes one of the departure points of my argument: Centralized coordination is necessary for achieving equitable objectives if there are high levels of decentralization. Therefore, I argue that centralized vertical and horizontal coordination – which I include in my analysis on interactive governance – should be related to lower inequality in a country. High interactive governance would especially be relevant as a conditional effect, and could mitigate the negative effects of decentralization on inequality.

3.1.3 Decentralization, welfare state policies and inequality

Economic inequality, which measures economic distribution in a given space, is often times analyzed with respect to how it is related to welfare state policies in general, including social policies, such as unemployment insurance or minimum income schemes (Esping-Andersen and Myles 2009; Huber and Stephens 2001; Scruggs 2008). Welfare states engage in many different types of redistributive practices: As a general rule, the main targets of e.g. income transfers are people with low incomes, and therefore these kinds of transfers aim at targeting income inequality (Saunders 2010). Among advanced democracies, government redistribution through taxes and transfers is associated with less income inequality (Lupu and Pontusson 2011).

The link between a spatial analysis of inequality and the welfare state comes is based on the complicated balance between unity and diversity, again inspired by the federalism literature. In the words of Obinger et al. (2005): "*Federalism is an institutional device designed to secure unity by allowing a certain degree of diversity, whereas the primary goal of the welfare state is normally to enhance equal social rights for all citizens. Federalism and the welfare state thus seem to be at the opposite ends of a diversity-uniformity continuum*" (p.2).

Rueda and Pontusson (2000) demonstrate that countries that have large public sectors are more inclined to show more egalitarian earnings distributions. Moreover, social spending, as a general measure, is indicative of the extent of a welfare state. While some authors have argued that higher levels of social spending, (which is usually given for a welfare state) will lead to more income redistribution, others also point out to the importance of institutional designs in welfare states, such as the design of unemployment benefits, than the sheer size of welfare states. Scruggs (2008) argues that welfare benefit generosity is a better determinant of redistribution than public spending. A study on 15 OECD countries shows that a 10 percent increase in social spending would cause 1 percent income inequality reduction (Esping-Andersen and Myles 2009). However, as the authors also caution, the impact of welfare state's redistributive impact on reducing income inequality needs to be disaggregated into its components, such as taxation, income transfers and services. The structures of tax and social insurance systems are regarded as important measures of income distribution, since it takes into account the proportion of total income involved (Salverda, Nolan and Smeeding 2009), which I explore in my case studies.

The overall decreases in redistributive social transfers in the OECD countries, compared to the levels up until the 1970s is regarded as one of the mechanisms through which income inequality increased in the period after the 1980s (Atkinson 2015). While analyzing redistributive policies, it is important to consider that these policies are made against the backdrop of the different types of welfare state categorizations that produce these policies. Using Esping-Andersen's classification (1990), whether a welfare state is liberal, social democratic/universalist, or corporatist/conservative significantly impacts the types of redistributive policies that are produced, as I will focus on in my cases. For example, some welfare states focus more on social security and redistribution, which would be more conducive for targeting and reducing inequality levels. Also, pro-targeted welfare states, such as the US or Australia are expected to lead to less income equalization than others (Esping-Andersen and Myles 2009; Esping-Andersen 1990; Palme 2006; Moene and Wallerstein 2003). Therefore, in the analysis, it is important to distinguish between certain redistributive policies of the types of welfare states and the mechanisms that target the reduction of inequality more than others do (Esping-Andersen and Myles 2009).

Due to the fact that not all federal arrangements are similar, the way federalism impacts the welfare state also shows variation based on the heterogeneous institutional structures and actor preferences in different types of welfare state policies (Obinger et al. 2005). We can apply the same logic to countries with different types of decentralization: Political and administrative decentralization without fiscal decentralization would leave the regions more in central government control in terms of financing their revenues. Therefore, many tax and redistributive policies might not be impacted. For example, in France, administrative decentralization has been on the rise, but the attainment of the equality fiscal capacity and the revenue of subnational governments is an important policy, carried out by the central government.

As stated earlier, one of the key components of my argument is **how fiscal decentralization – as a feature of the welfare state - impacts income inequality**. The elements of fiscal decentralization, such as the authority of regions in taxes and redistribution can all be studied under the general framework of the welfare state policies. According to Oates (1972), tackling of inequality is an important task of the public sector in a country where 'optimum welfare state' is sought after, but highly decentralized fiscal systems can have different communities whose level of willingness to carry out an egalitarian distribution of income can vary to a great extent. To recap the definitions, *fiscal decentralization* can manifest itself with the regional governments' authority to set the bases and rates of taxes in their jurisdiction, or how they can borrow money from financial markets easily. These would be a part of the *self-rule* component of fiscal decentralization, while the *shared-rule* of fiscal decentralization would center on how much regions have veto power or shared policy making prerogatives in the distribution of tax revenues (Hooghe et al. 2016). Therefore, the distinction between these two elements is key.

Again, high levels of fiscal decentralization can increase inequality, because of the discrepancies among regions in terms of a) their revenues, b) bureaucratic capacities to overcome unequal distribution levels. For example, with fiscal federalism, richer regions can attract more investment with their larger tax bases, and regions might grow in different rates, leading to differentiated average incomes (Sorens 2012). In a nutshell, regional governments would need to rely on their own revenues. To understand all this, it is important to examine the political, fiscal and in some cases the administrative types of decentralization. Furthermore, administrative decentralization can impact inequality if there are variations among the regional units in order to implement the public policies. In a decentralized structure, interregional differences in capacities can also lead to substantial disparities in redistribution and infrastructures to overcome redistributive problems. Furthermore, decentralization can come with regional economic differentiation, where regions develop in distinct ways, leading to higher regional – and then national income inequality. For example, the differences in factor endowments among the regions - as a reflection of the Hecksher-Ohlin trade model - could lead to asymmetric regional development, if there is more political and administrative decentralization for these differences to flourish, as seen in the case of Spain (Martínez-Galarraga 2015). Distinct distributive processes may emerge in different regions, in both unitary and federal states, contribution to higher inequality among the regions. Without equalizing practices – either through equalization transfers or intergovernmental grants - , this would lead to regional differentiation, which can also pave the way for higher overall national inequality.

Fiscal equalization programs can be concerned with horizontal fiscal equity, also known as inter-jurisdictional fiscal equity, and also vertical (interpersonal) equity. Vertical equity refers to the consistency of a subnational unit's revenue raising capabilities with its expenditure responsibilities and needs (Kitchen 2007). If vertical transfers from the central government aim at providing a minimum level of resources with the lump-sum transfers, then this is considered a "federalist" approach (Boadway and Shah 2007). This can create room for discrepancies among the regions, if the grants are not discretionary. Therefore, in federal systems and in fiscally decentralized structures, intergovernmental equalization transfers and different types of grants are an important component of guaranteeing the desired level of vertical or horizontal equity, which I will include in my analyses of my cases. Also, these welfare state policies reflect the nature of decentralization, especially as will be seen in the case of Spain (Leon 2010).

(Interpersonal) redistribution at the national level and interregional (horizontal) redistribution are two concepts that are highly correlated with each other. If the system of taxes and transfers is centralized, then we should expect to see distributive consequences across regions. On the other hands, in the decentralized systems, we should expect to see regions to be the key authority for interpersonal redistribution across the regions, in a more horizontal framework. This also depends on the vertical and horizontal coordination fiscal flows, which I explore in my case studies.

Fiscal equalization transfers aim at reducing fiscal disparities across different jurisdictions, mainly but not necessarily, in federal systems. Those that are carried out by the central government aim at vertical equalization, while those that are carried out by subnational governments themselves aim at horizontal equalization (Dafflon 2007). Yet, the latter can also be centrally coordinated and planned. As this dissertation will demonstrate, unitary systems such as France and Sweden also engage in such transfers. Intergovernmental transfers aim at correcting the imbalances among the regions in decentralized fiscal systems and are an important part of intergovernmental relations, both in fiscal federalism studies and in other studies concerning decentralization (Ferrer-i-Carbonell 2014). Intergovernmental transfers can correct the fiscal inefficiencies or the horizontal fiscal inequities of federal systems where subnational units would have different needs or capacities (Boadway and Keen 1997).

Furthermore, the literature on fiscal federalism, and other literatures on territorial governance look at intergovernmental grants. Earmarked grants are those that are given for specific purposes, and non-earmarked grants can be used for the subnational tax revenues of the subnational units, indicating higher decentralization.

Higher fiscal decentralization, in the absence of fiscal control (shared-rule) could leave regions to their own devices to rely on their own tax revenues, as is seen in the case of Spain (Colino and Kölling 2014). This echoes the argument that countries with more regional fiscal authority can experience more regional and then national income inequality due to the lower inclination for achieving the centralizing inequality offsetting effects of welfare states. Therefore, it is important to look whether fiscal flows that are created by the territorial governance structure are centralized or not, and whether they reach their a) horizontal, b) vertical equalizing aims.

According to Obinger et al. (2005), if welfare states in some federations allow “distinct policy orientations” and various voter preferences and initiatives, this can lead to a patchwork of heterogeneous social policy programs” (p. 40). Beramendi (2007) also argues that federalism and decentralization can create the necessary environment for the central and subnational governments to act “non-cooperatively”. Therefore, higher regional self-rule can pave the way for lower regional shared-rule. To understand this, it is important to distinguish between these two elements of decentralization, rather than the unitary vs. federal dichotomy. Still, studies focus on federalism as a general measure to show its impact on welfare states. In a study on 21 OECD countries, Castles (1999) finds that federalism, through its several constitutional veto-points have inhibited the expansion of a welfare state that is protective of its people with social policies. Obinger et al. (2005) list six different reasons why federalism, can lead to differentiated welfare state policy outcomes within a state: “*Dynamics of welfare state development, program generosity, program uniformity across states or provinces, the extent of vertical redistribution, patterns of social policy intervention, the degree of policy experimentation and innovation*”: (p.30).[4] Again, the emphasis is on redistributive patterns that can be heterogeneous in a federal system. The authors argue that, by looking at how federal institutions impact redistributive and social policies, we can understand how political decentralization and social policy interact. Overall, the absolute and the net redistribution levels indicate the difference between market and net income inequality, as defined earlier. However, not all redistribution comes from taxes and transfers, but also from other social policies and services, such as sickness pay, minimum income schemes, unemployment insurance, work welfare benefits, or even healthcare. Therefore, the case studies will include a look at the welfare state policies that are impacted by decentralization,

[4] Obinger et al. (2005) acknowledge that social policies created by the federal structure may then impact the jurisdictional arrangements over time. Furthermore, reverse causality has been shown for redistribution and decentralization, such that income distribution determines choices in federations (Alesina and Spolaore 2003; Beramendi 2007; Wibbels 2005). According to these studies, distributional issues form the organizations of fiscal structures, in lieu of fiscal structures paving the way for different outcomes.

and are known to impact inequality directly. OECD frequently studies the extent to which different social policies, on their own, are responsible for reducing national income inequality figures in general in its specific country studies (2008, 2011).

In sum, the territorial governance structure of countries should work as an externality to increase inequality, because of the discrepancies among regions in terms of their revenues and/or bureaucratic capacities to overcome unequal distribution levels. Second, (self-rule) fiscal decentralization can obstruct the capacity of the central government to implement inequality reducing redistributive policies and to redistributive in a symmetric way. If the subnational units have redistributing power, we can presume the central government to have a less key role in redistribution.

Third, fiscal decentralization should hinder the ability of the central government to redistribute in a more standardized way through taxes and transfers due to the varying redistributive patterns, because the central tax might be relatively lower, or it could not be the main tax element that leads to asymmetric distribution. Furthermore, the willingness of 'rich' regions to provide for the poorer regions can be more ad hoc in decentralized systems, as is exemplified with the case of the rich region of Catalonia in Spain. Therefore, we can expect both fiscal and political decentralization to be associated with more inequality.

Yet, even in decentralized systems, if there is a harmonization of transfers and taxes among the regions, this can be more associated with lower inequality. This could be due to the existence of: a) more "shared rule" type of decentralization, whereby more standardized decisions will be taken by the subnational units towards equalizing goals and where subnational units are represented at the central level, b) strong central coordination. For example, in the case of Sweden, there is a centrally coordination financial equalization system, in a highly decentralized administrative system.

The territorial governance structure also has an impact on some fiscal and social welfare state policies that have been known to have an impact on income inequality, which I will explore in the case studies. Some are policies, such as unemployment insurance, public pensions or minimum income scheme policies, which directly target reduction of inequality. While it is difficult to establish direct causation with social policies and income inequality, some OECD studies (2008, 2011, 2015) have disaggregated income inequality reduction to attribute how much of this reduction is due to certain social policies. In my case studies, I aim to show the direct or indirect correlation of some these social policies with income inequality, such as unemployment policies, public pensions, minimum income schemes or even health care policy.

The next section expands on the second part of my theory, which centers on my argument on interactive governance. In my quantitative studies, I operationalize interactive governance by the scores of the shared-rule elements of the Regional Authority Index (Hooghe et al. 2010), and especially fiscal control, as fiscal intergovernmental relations are a key part of my theory. However, the argument on interactive governance needs to be considered with its various elements mentioned in the chapter on definitions, such as intergovernmental relations, and most importantly, the roles of non-state actors in the policy making process that matters for distributional outcomes. Therefore, the case studies will allow me to operationalize interactive governance more specifically.

3.2 SECOND PART OF THE THEORY: INTERACTIVE GOVERNANCE AND INCOME INEQUALITY

The argument of interactive governance allows me to measure the combined impact of structure and agency on income inequality. As defined earlier in the chapter of the descriptions of the variables, interactive governance examines whether *social* and *political* actors that have diverging interests can formulate policies towards common goals by deploying various resources. I argue that the application of the argument on interactive governance is enlightening in understanding the creation of policies that would matter for income inequality, or efforts that would aim at dealing with inequality in general.

How is the interactive governance argument related to territorial governance or decentralization? The decentralization process, through which power is devolved to the subnational units a country involves interaction between different governmental levels in a state, as well as among different state and non-state actors. Even officially unitary countries might be *de facto* more federal, and subnational units might be interacting with the central state (with vertical coordination by the central state), as well as with each other (horizontal coordination). Kooiman's (2003) model of interactions in governance proves to be useful in understanding the relationship between these levels. He argues that interactions are made up of *intentional* and *structural* levels, whereby the governing actors, 'co-influence the *structural* conditions within which they govern by changing or conserving them, while *structural* conditions co-determine these *governing activities* by enabling or controlling them" (p. 19). Therefore, structural conditions, actors and processes can be intertwined in redistributive policy making.

While the interactive governance approach has not been used as an explanatory variable for understanding the link between federalism and inequality, one does not need to look too far to find its traces in the relevant literature. We know that a regional government can exercise authority either in its own jurisdiction, or in the country as a whole, which refers to the well-known distinction between 'self-rule' and 'shared-rule' (Elazar 1987; Lane and Ersson 1999; Riker 1964). Therefore, interactive governance can be considered also as the reflection of the shared-rule aspect of decentralization. There is a gap in the literature in terms of the extent to which the "co-decision making" or the "shared-rule" of subnational units can matter for the income distribution of a country. This argument aims to fill this gap by amalgamating these concepts under the umbrella term of "interactive governance" in the following way: To apply my theory on interactive governance, I test whether intergovernmental relations – interactions between the officials of the central government and the subnational units, and 2) the interactions of the central government or the officials of various subnational units with relevant non-state actors (such as trade unions or wage-setting organizations), 3) the actions of non-state actors (e.g. trade unions) in general, and their interactions with state officials will have a significant impact on national income inequality.

At first glance, the interactive governance process seems to be 'decentered' as there is constant interaction between various levels of a plurality of actors in the governance scheme. However, this does not necessarily mean that unitary states cannot have interactive governance, as they are also prone to decentralization. Nor does it lead to a conclusion of 'governance without government' since the state has to provide resources and capacities for the interactive governance process in both centralized and decentralized coordination (Torfing et al. 2012; Benz and Papadopoulos 2006). Thus, it is important to compare how interactive governance assumes different forms in unitary and in federal states, and the very consequences of the nature of this 'interaction'. Yet, to understand the impact of interactive governance, the arguments on the importance of federalism need consideration as well. Braun et al. (2003) offer two different channels for why federalism should matter for fiscal policy making, which can be applied to our general examination of territorial governance structures. The federal architecture matters for the central state's a) *capacity to implement policies, b) the capacity to coordinate*. As Dixit and Londegran (1998) argue, in federal – and decentralized systems – redistribution does not only occur at the central level, and "the lower tiers have access to many policy instruments that have redistributive consequences" whose interactions must be taken into account when analyzing the economic outcomes.

3.2.1 Intergovernmental relations and interactive governance, and inequality

In the first part of the interactive governance argument, the main actors are the central government and the representatives of the subnational units, such as different ministers of policies that matter for inequality, such as the finance ministers. If the federal constitutional structure detracts from the policy implementation and coordination capacity of the central government, this can hinder the ability to tackle income inequality in a country, unless there are compensating intergovernmental platforms that bring together the executives or legislators from various levels. I expect centralized and unitary states to have stronger central coordination capacities, but this does not necessarily have to be the case. Therefore, this first component constitutes the "governmental" component of interactive governance, as distinct from the second component that incorporates social actors.

3.2.2 Social actors and interactive governance and inequality

The role of labor market institutions on economic outcomes has been studied extensively in recent years. Wage setting organizations are associated with pay inequality, which in turn impacts inequality (Beramendi and Rueda 2014). Thus, by this token, centralized wage bargaining, strong unions and large public sectors should be expected to offset the effect of market forces that are conducive to increasing earnings inequality by leading to more standardization and more influence for the increase of wages (Kenworthy and Pontusson 2005; Glaeser 2006). Within interactive governance, wage coordination captures the cross-national differences of the levels at which wage agreements are negotiated. Wage coordination measures 'the degree of intentional harmonization in the wage setting process – wages and salaries - ' and how centralized the peak bargaining process is (Wallerstein 1999). Countries that rank higher on wage coordination would have a more centralized process of the determination of wages and salaries, and thus I expect higher wage coordination to lead to less income inequality. As Atkinson (2015) claims, it is difficult to encapsulate the bargaining strength of unions in quantitative indicators, and wage-setting centralization is an important indicator to understand their impact. As stated earlier, centralized wage bargaining and strong union membership should be expected to counterbalance the effect of market forces that increase inequality (Kenworthy and Pontusson 2005; Glaeser 2006). Furthermore, net union membership is found to have a significant impact on income inequality (Rueda 2008; Moene and Wallerstein 2003). These would also be forces that aim at more interactive governance. Here, it is important to mention the importance of corporatism again. Corporatism does not necessarily denote interactive governance, yet the nature of the embedded social actors in a corporatist structure makes it more prone to interactive governance. My discussion on interactive governance will be against the backdrop of a general discussion on corporatism, as well as the decline of corporatism.

As far as the social actors are concerned, trade unions are important institutions as they have historically worked towards curbing inequality (Visser and Checchi 2009). Especially through their bargaining coordination and their wage policies, unions can play an important role to this end. Therefore, I argue that the more centralized and the more expansive the unions are, the more interactive the governance will be. For example union density and coverage are expected to have equalizing effects on the earnings distribution, not only because unions strive for wage standardization and seek to increase the earnings of its members but also through indirect effects, such as promotion of social expenditures that benefit low-income groups as a whole (Mahler 2004).

On the whole, I argue that countries that have regions with more authoritative ‘shared-rule’ components, or more ‘interactive governance’ overall should display similar patterns of redistribution even if they are decentralized. I expect interactive governance to mitigate the possible negative effects of decentralization on inequality. Applying this line of thinking to fiscal policies, in addition to deciding their own tax rate, regional governments can also influence the distribution of national tax revenues and grants in intergovernmental meetings or via their representatives in the legislatures - for more standardized redistributive policies. Hooghe et al. (2016) coin this as ‘fiscal control’, which I argue is related to interactive governance, as there is a process of deciding on issues that will impact different governmental levels. Other shared rule aspects in addition to fiscal control can be in law making, executive control or constitutional reform, which indicate the level of ‘co-decision making’. There are countries that have similar levels of fiscal decentralization, in terms of their ‘self-rule’ but varying in terms of their ‘shared-rule’, which is indicated by their co-decision powers.

The link between more interactive governance, as defined in this dissertation based on Torfing et al. (2012), with less income inequality is also echoed in Atkinson’s (2015) proposals to reduce the extent of inequality. He supports the following ideas for reducing the extent of inequality, which incorporates both the intergovernmental and the social actors side of my interactive governance argument:

> *“Proposal 2: Public policy should aim at a proper balance of power among stakeholders, and to this end should a) introduce an explicitly distributional dimension into competition policy, b) ensure a legal framework that allows trade unions to represent workers on level terms, c) establish, where it does not already exist, a Social and Economic Council involving the social partners and other nongovernmental bodies.*
>
> *…*
>
> *Proposal 4: There should be a national pay policy, consisting of two elements: a statutory minimum wage set at a living wage, and a code of practice for pay above the minimum, agreed as a part of “national conversation” involving the Social and Economic Council” (p. 237).*

For example, some versions of the Social and Economic Council that is proposed by Atkinson exist in some of the cases of this dissertation, such as Spain and Germany; whose effects in inequality will be explored in more detail subsequently.

I argue that by sharing common objectives and resources, and applying a ‘bottom-up’ approach, higher levels of interactive governance should offset the negative impact of federalism (or more devolution to regions) on increasing inequality. Also, unitary countries that are more interactive are expected to have lower inequality levels. In sum, countries that have:

a) intergovernmental relations with more established institutional structures concerning matters related to inequality

b) more centralized / coordinated wage setting procedures are countries with more interactive governance, and should experience lower overall national inequality levels, as well as lower regional inequality levels. Again, even in cases of high decentralization or high regional (self) authority, high interactive governance can offset the inequality inducing effects of decentralization.

For example, Sweden is an example of interactive governance where there is a decentered governance structure with vertical and horizontal coordination steered by the central government. Thus, in both unitary and federal states, subnational units *interact* with the central state in policy making and redistribution, which, I argue, can have a significant impact on income inequality levels (Dixit and Londegran 1998). The impact of interactive governance on inequality is clearer with the comparison of France and Sweden, the former being a higher interactive governance country than the latter.

3.3 TESTABLE HYPOTHESES

Based on the arguments of my theory, I will test the following two hypotheses in my quantitative chapter:

Hypothesis 1: OECD countries in Western Europe that have more overall regional authority (more political, administrative and fiscal decentralization) are more likely to have higher income inequality.

Hypothesis 2: Fiscal authority is a significant predictor of income inequality in OECD countries in Western Europe.

2a: The higher the fiscal autonomy of subnational units, the higher the national income inequality (self-rule aspect of decentralization).

2b: The higher the fiscal shared rule level of subnational units with the central government, the lower the national income inequality (fiscal shared-rule aspect of decentralization – proxy for the variable of interactive governance).

Hypothesis 2b aims at testing interactive governance, by using fiscal shared rule as a proxy of interactive governance. This needs further explication: The variable of interactive governance is harder to operationalize than decentralization. In the quantitative chapter, I operationalize interactive governance with fiscal shared rule, in the absence of any better quantitative measure for capturing interactive governance. In the qualitative chapter, I test the impact of interactive governance on income inequality by building upon the argument of fiscal shared-rule from the quantitative studies, but extending the definition of the variable. I test whether decentralization as a whole, fiscal decentralization and fiscal shared rule are significant determinants of income inequality are not in my case studies as well. Yet, at the same time, rather than using just fiscal shared rule as a proxy, I study the specific intergovernmental relations and social actors that comprise interactive governance, and test the significance of interactive governance on income inequality by specifying this variable further. The detailed case studies allow me to look at the impact of political and fiscal decentralization from various angles as well, with different measures of operationalization. For example, I illuminate different processes through which countries decentralize, such as the European Union regional policies, and I look at the impact of these processes as well. Therefore, in my case studies, the hypothesis that I test concerning interactive governance is better phrased as follows:

Hypothesis 3: Countries that have high interactive governance are expected to be associated with less national income inequality.

(Even in the cases of high decentralization, high interactive governance can mitigate decentralization’s inequality inducing effects).

4.0 QUANTITATIVE STUDY ON DECENTRALIZATION AND INCOME INEQUALITY

In this chapter, I conduct a statistical analysis on the relationship between decentralization and inequality. This dissertation seeks to assess the effect of varying degrees of regional authority on national income inequality levels in Western European countries. For the purpose of understanding the hypothesized effect of varying degrees of regional authority on income inequality, a fixed effects model is applied, to see whether the results are dependent on any particular effect pertaining to a country in the sample. The data set includes 17 OECD countries in Europe with information on subnational government levels with an average population of 150,000 or more citizens. The unit of analysis is country-year, and it includes data for the time period of 1960 to 2006. Including the OECD countries in the analysis is justified since I would like to compare industrialized 'comparable countries' in Western Europe for income distribution, in order to single out the effects of regional authority.

4.1 DATA AND VARIABLES

The dependent variable: The dependent variable is the national NET INCOME INEQUALITY level, which is operationalized by the Gini coefficient. Measurement of the dependent variable is a complex issue.[5] The unit of analysis for this study is country year for the years 1960 – 2006. Also, Gini scores are calculated with different determinants for some countries.[6] As explained in the chapter on the definitions of the variables, I use the post-tax net income inequality measure, which is the measure after taxes and transfers, in order to control for income inequality after redistribution and social spending, as my argument is centered on how decentralization impacts the redistributive role of the countries.

Independent variables: I operationalize the main independent variable of this study, which measures decentralization with Hooghe, Marks and Schakel's *"Regional Authority Index"* (2008, 2010). In order to measure decentralization as a whole, the aggregate regional authority index score consists of the addition of the following characteristics: The *self-rule* and the *shared rule* aspects of the relevant regions in one country, which in total are measured along eight dimensions. The variables that make up the *self-rule* score are *institutional depth, policy scope, fiscal autonomy and representation*. *Institutional depth* refers to the level of autonomy from the central government that the regions possess. *Policy scope* aggregates the extent to which regions can carry out economic, cultural-educational, and welfare policies. *Fiscal autonomy* measures the authority of regions in setting the base and rate of taxes. *Representation* is the capacity of regional actors to select regional office holders. The variables making up the *shared rule* score measure the authority exercised by the regional government in co-determining decision making at the national level. The four components are: *Law making, executive control, fiscal control,*

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5 It is acknowledged that measurement of inequality is a complex matter, as specified in an earlier chapter. Inequality data taken from Frederick Solt's Standardized World Income Inequality Database (SWIID), which standardizes the United Nations University's World Income Inequality Database, known as the most recent effort bringing together inequality data. It uses data collected by the Luxembourg Income Study as the standard. For a good explanation of that data, see Birchfield 2008. The SWIID has comparable Gini indices of gross and net income inequality for 171 countries from 1960 to the present, and estimates of uncertainty in these statistics.
6 In this data set, the Gini coefficient measure is on a scale of 0 to 100. The larger the Gini coefficient, the more income inequality there is in that country.

constitutional reform. *Law making* refers to the role of regions in national legislation and the extent to which regions are represented in the national legislature. *Executive control* measures the extent to which regional governments share executive authority with central government in intergovernmental meetings. *Fiscal control* deserves special emphasis, which measures the shared rule on taxation. If countries have regional governments that negotiate over the distribution of tax revenues either in intergovernmental meetings or via their representatives in a legislature with regional representation, they score higher on this scale. *Constitutional reform* measures the extent to which regional governments have assent in constitutional changes. Table 3 summarizes the scale of these measures.

Table 3. Components of the Regional Authority Index

1. Institutional depth: The authority exercised by a regional government is autonomous rather than deconcentrated. (Measured from 0 to 3)
2. Policy scope: The range of policies for which a regional government is responsible (Measured from 0 to 4)
3. **Fiscal autonomy**: The extent to which a regional government can independently tax its population. (Measured from 0 to 5)
4. Representation: The extent to which a regional government is endowed with an independent legislature and executive. (Measured from 0 to 4, combination of both the executive and the legislature measures on a scale of 0 to 2)
5. Law making: The extent to which regional representatives co-determine national legislation. (Measured from 0 to 2)
6. Executive control: The extent to which a regional government co-determines national policy in intergovernmental meetings. (Measured from 0 to 2)
7. **Fiscal control**: The extent to which regional representatives co-determine the distribution of national tax revenues. (Measured from 0 to 3)
8. Constitutional reform: The extent to which regional representatives co-determine constitutional change. (Measured from 0 to 3)

Therefore, the *Regional Authority Index* (RAI) score of a country is made up by adding all of the abovementioned relevant scores together. However, the scores are also weighted according to certain conditions in the countries. The more regional tiers a country has, the higher is the country score, all other things equal. According to Hooghe et al. (2008) among the abovementioned eight dimensions, the Cronbach's alpha in 2006 is 0.94, indicating that the dimensions actually do cover a single construct to a great extent. This index presents useful measures of different types of decentralization that actually measures the territorial institutional arrangements, which makes it appropriate it to use in this study. I first use the aggregate measure of the regional authority index, rather than using different disaggregate measures of the construct. Then I use *fiscal autonomy* and *fiscal control* and remove RAI in the following models, in order to prevent multicollinearity. Analyzing the index data, one can see that no country in the sample has experienced a transition from a more regionalized structure to a less regionalized structure during the period covered. However, certain countries have transitioned from a less regionalized to a more regionalized structure over time, such as Belgium, France, Italy and Spain.

As explained in the theory section, I also single out certain components of the aggregate RAI index to test my second hypothesis. Rather than the aggregate RAI score, I use FISCAL AUTONOMY and FISCAL CONTROL indices in Model 2 and 3, to test Hypothesis 2a and Hypothesis 2b. Whereas FISCAL AUTONOMY corresponds with self-rule of fiscal authority of subnational units, FISCAL CONTROL indicates the shared-rule component of decentralization, where the subnational units and the central government co-decide on redistributive matters. I use them separately to see whether the causal mechanism of decentralization and inequality goes through the channel of a centralized/decentralized fiscal structure, which measures tax autonomy and co-decision on tax revenues, respectively. In Model 4, I include both FISCAL AUTONOMY and FISCAL CONTROL together since they are not mutually exclusive indices. Model 4 aims to control for the effect of these variables on one another in a discussion of income inequality.

Control Variables: Additionally, I use some control variables to see whether the causal effect between regional authority and income inequality is affected by certain variables that have been shown to be causes of inequality in the literature. To account for some economic factors that might have an effect on national inequality levels, I use the control variables of Gross Domestic Product (GDP) per capita, the overall unemployment level (UNEMPLOYMENT) and annual economic growth (GDP GROWTH).[7]

Since unemployment is one of the key indicators equality in the literature (Albanesi 2007; Björklund 1991; Blinder and Esaki 1978; Buse 1982; Gustafsson and Johansson, 1999; Weil 1984), I use unemployment as a control variable, which is measured in percentages. The variable of UNEMPLOYMENT enables us to control for variations in the working age population who would be eligible for social transfers (Lupu and Pontusson 2011). I expect countries that have more unemployment to have higher levels of inequality. GDP GROWTH is also measured in percentages, which can also assume a negative value for some cases.[8] Annual growth is especially known to be a positive indicator for social spending, which may or may not translate to redistributive outcomes (Lupu and Pontusson 2011). GDP per capita has also been used a determinant of income inequality, with varying effects in less developed and OECD countries (Reuveny and Li 2003). Another control variable, EMPLOYMENT INDUSTRY, measures the percentage of people employed in the industry, shown to have a negative impact on overall inequality (Gustafsson and Johanson 1999).

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[7] Data taken from Penn World Tables. Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 7.0, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, May 2011.

[8] Data taken from Klaus Armingeon, David Weisstanner, Sarah Engler, Panajotis Potolidis, Marlène Gerber, Philipp Leimgruber. Comparative Political Data Set I 1960-2009, Institute of Political Science, University of Berne, 2011.

A well-established finding in the literature is that democracy is negatively related with inequality (Jackman 1974; Müller 1988; Reuveny and Li 2003; Rubinson and Quinlan 1977). In fact, democracy offers more opportunities for participation, thereby allowing the poor to demand more equitable redistribution. Since democratic leaders must care about reelection, they tend to adopt redistributive policies that favor the lower classes, such as welfare spending or minimum wage laws (Boix 1998; Chan 1997; Reuveny and Li 2003). Although most of the countries in the database are democracies during the period under analysis, I include the DEMOCRACY as a control variable, which is operationalized by the Polity IV score, in order to assess whether varying degrees of democracy has an impact on economic redistribution. Furthermore, some of these countries, such as Spain or Portugal have not been democracies since the beginning of time. Also, the scores of Germany before the unification correspond to scores of Western Germany, and after unification, the reunited Germany scores.

I also include variables which are, on general, expected to be higher in welfare states and highly centralized states, such as public spending, social security transfers or net union membership. The measures of net union membership, social security transfers and total social expenditure aim to control for factors that are used frequently in the literature that links welfare states and income inequality (Rueda 2008; Moene and Wallerstein 2003). As stated earlier, centralized wage bargaining and strong union membership should be expected to counterbalance the effect of market forces that increase inequality (Kenworthy and Pontusson 2005; Glaeser 2006). The NET UNION MEMBERSHIP variable measures net union membership, (gross minus independent workers, students, unemployed or retired members), which is expected to have a negative impact on income inequality (Cusack, Iversen and Rehm 2008). SOCIAL EXPENDITURE, as a dimension of welfare states, measures the total public and mandatory private social expenditure as a percentage of GDP (Esping-Andersen 1990). The variable of SOCIAL SECURITY TRANSFERS measures these transfers as a percentage of GDP and includes social assistance grants and welfare benefits paid by general government, like benefits for sickness, old-age, family allowances, etc.[9] Government redistribution through taxes and transfers is argued to be associated with less income inequality (Lupu and Pontusson 2011). The last control variable I include is WAGE COORDINATION[10] which aims to capture the cross-national differences of the levels at which wage agreements are negotiated, which looks at how Model 5 also includes another control variable WAGE COORDINATION. Wage coordination measures 'the degree of intentional harmonization in the wage setting process – wages and salaries - ' and how centralized the peak bargaining process is (Wallerstein 1999). Countries that rank higher on wage coordination would have a more centralized process of the determination of wages and salaries, and thus I expect higher wage coordination to lead to less income inequality. Table 4 lists the countries included in the dataset[11], and Table 5 gives the summary statistics of the variables included in my models.

[9] Data taken from Comparative Political Data Set I.
[10] Data taken from Kenworthy (2001).
[11] Iceland is dropped because of missing data.

Table 4. Countries Included in the Dataset

1. Austria
2. Belgium
3. Denmark
4. Finland
5. France
6. Germany
7. Greece
8. Ireland
9. Italy
10. Luxembourg
11. Netherlands
12. Norway
13. Portugal
14. Spain
15. Sweden
16. Switzerland
17. United Kingdom

Table 5. Summary Statistics of the Quantitative Study

Variable	Mean	Std. Dev.	Min	Max
Net income inequality (scale of 0 to 100)	27.80114	4.186748	19.7	39.1091
Regional authority (aggregate score)	10.98601	8.756616	0	32.1
Fiscal autonomy (scale of 0 to 5)	1.547167	1.511185	0	4.9
Fiscal control (scale of 0 to 3)	.5374384	.8350535	0	3
Democracy (scale of -10 to 10)	8.971631	3.722842	-9	10
GDP per capita (in $)	14471.62	11611.04	716.18	81428.24
GDP growth (in %)	3.432898	2.627138	-7.3	13.
Unemployment (in %)	5.329254	4.261337	.002472 24.1714	5.329254
Employment industry (in K)	2802.596	3472.426	23.6	15068
Social expenditures (% of GDP)	22.60482	4.909158	10.15	36.178
Wage coordination (1- 5)	3.675	1.254	1	5
Net union membership (total, in K)	2407.992	2625.728	52.4	11969.4
Social security transfers (% of GDP)	13.6724	4.531272	2.3	28.9093

4.2 RESULTS OF THE QUANTITATIVE STUDY

I test my model, taking the net national income inequality as my dependent variable. The fixed effects model produce mixed results on regional authority and income inequality. Table 6 shows the results, where the impact of aggregated regional authority scores of countries, regional fiscal autonomy and regional fiscal control, are tested separately on net national income inequality levels after transfers in European countries.

Table 6. Determinants of Net Income Inequality

VARIABLES	(1) Net income inequality	(2) Net income inequality	(3) Net income inequality	(4) Net income inequality	(5) Net income inequality
Regional authority index	0.0681				
	(0.0497)				
Fiscal autonomy		0.556***		0.372**	0.396***
		(0.141)		(0.147)	(0.152)
Fiscal control			-2.880***	-2.381***	-2.993***
			(0.583)	(0.612)	(0.644)
Democracy	-0.303	-0.128	0.0507	0.0178	-0.0999
	(0.368)	(0.338)	(0.336)	(0.335)	(0.626)
GDP per capita	7.13e-05***	6.68e-05***	6.58e-05***	6.11e-05***	7.05e-05***
	(1.50e-05)	(1.45e-05)	(1.43e-05)	(1.43e-05)	(2.41e-05)
GDP growth	-0.0713	-0.0550	-0.0557	-0.0537	-0.0386
	(0.0440)	(0.0423)	(0.0419)	(0.0416)	(0.0452)
Unemployment	0.0682*	0.0821**	0.0871**	0.0937**	0.148***
	(0.0385)	(0.0381)	(0.0377)	(0.0375)	(0.0453)
Employment industry	0.00165***	0.00151***	0.00185***	0.00174***	0.00206***
	(0.000319)	(0.000314)	(0.000313)	(0.000314)	(0.000296)
Social expenditures	-0.0458	-0.0501	-0.0304	-0.0374	-0.374***
	(0.0507)	(0.0499)	(0.0494)	(0.0492)	(0.0658)
Net union membership	-0.00184***	-0.00173***	-0.00202***	-0.00194***	-0.00240***
	(0.000284)	(0.000279)	(0.000279)	(0.000279)	(0.000261)
Social security transfers	0.0449	0.0386	0.0305	0.0254	0.210***
	(0.0494)	(0.0485)	(0.0481)	(0.0478)	(0.0496)
Wage coordination					-0.208*
					(0.111)
Constant	28.32***	26.72***	27.02***	26.78***	33.52***
	(3.490)	(3.324)	(3.288)	(3.268)	(6.299)
Observations	436	436	436	436	258
R-squared	0.214	0.239	0.254	0.266	0.484
Number of countries	17	17	17	17	13

As the results of Model 1 demonstrate, ranking higher on overall REGIONAL AUTHORITY scores is not a significant predictor of overall income inequality. Therefore, based on the results of this study, a high level of overall decentralization, or federalism in general, is not found to be a predictor of net income inequality, counter to previous studies that link federalism with inequality. This result accentuates the importance of the fiscal powers of regions in decentralization, rather than using an aggregated score that measures the overall political decentralization. Thus, Hypothesis 1 does not hold. The results also indicate that democracy is significantly and positively related to income inequality, as well as unemployment and employment in industry, as suggested by previous research. Net union membership is also negatively related to income inequality, as expected. However the variable of social security transfers fails to reach statistical significance, showing that the amount of social security transfers does not account for net income inequality.

Model 2 takes FISCAL AUTONOMY as its proxy of decentralization, rather than the combined RAI score. As predicted in Hypothesis 2a, countries with regions of higher fiscal autonomy have more national net income inequality; statistically significant at the 99 percent confidence level. Therefore, the countries where the regional government sets the rate of more of the major taxes (personal income, corporate, value added or sales tax) are expected to have a more unequal distribution of income. This autonomy gives room to regional governments to decide on their own taxes, and if all the regions have varying tax structures, this will lead to discrepancies between regions in redistribution, leading to more overall income inequality.

Model 3, where the key explanatory variable is FISCAL CONTROL, is also in line with my expectations in Hypothesis 2b. FISCAL CONTROL is statistically significant at the 99 percent confidence level. Thus, we can argue that higher shared rule on tax related matters in OECD countries might be 'bringing the regions together' and bridging the gaps in overall income inequality levels in a country. We can also claim that since interactive governance is operationalized with fiscal shared rule, there is evidence for higher interactive governance to be associated with less income inequality. While FISCAL AUTONOMY is a component of the self-rule of the regions, FISCAL CONTROL looks at how regions share power in fiscal issues with the central authority. Including FISCAL CONTROL in lieu of FISCAL AUTONOMY does not change the coefficients or statistical significance of the control variables.

Model 4 aims to control for the effect of FISCAL CONTROL when investigating the effect of FISCAL AUTONOMY, and vice versa. The results are similar to the previous two models in that the signs and the statistical significance of these two main independent variables do not change. Thus, we can conclude that the *self-rule* component of fiscal authority, measured by FISCAL AUTONOMY increases overall income inequality, while the *shared-rule* component of fiscal authority, measured by FISCAL CONTROL decreases net income inequality, when controlling for centralized aspects of welfare states, such as social expenditures, social security transfers and union membership. These measures enable us to analyze the fiscal authority of regional governments independently of their revenues or spending (Hooghe et al., 2010).

In Model 5, I add the WAGE COORDINATION variable to the last model where I include both FISCAL AUTONOMY and FISCAL CONTROL in the model, and the results are as expected in Hypothesis 2a and 2b. The model has similar results to the previous one, and WAGE COORDINATION is negatively and significantly related to income inequality as expected.

The results of the statistical analysis show that fiscal autonomy and fiscal control granted to regions in the OECD countries in Europe have significant impacts on the *Gini* coefficient, which measures national income inequality levels. The more fiscal autonomy the regions have, the higher the expected income inequality. On the other hand, more shared rule between the subnational regions and the central government leads to less income inequality. However, the aggregate regional authority index does not seem to be statistically significant, and thus, it calls for caution against claims that high levels of federalism (or high levels of overall decentralization) will lead to higher income inequality under all circumstances. I explore this finding further in the case studies, by looking at different components of decentralization, and the different processes through which countries have decentralized.

The quantitative chapter of this dissertation speaks to the work of previous scholars on this issue (Rodden 2004; Boix 2003; Bolton and Roland 1997) but presents a more refined and focused approach to decentralization, and focuses on the impact of the fiscal authority component of decentralization on inequality. The next step in this work is to establish the fact that decentralization and interactive governance create distributive outcomes exogenously for national as well as regional inequality. As this dissertation looks at the impact of the institutional structure on inequality, the discussion focused on country level institutional variables that matter for inequality. Furthermore, as data from the RAI is at the national level, in the quantitative analysis, I tested the significance of these variables on national Gini levels. However, for the cases where data are available, I will extend this argument to regional inequality in my case studies. Furthermore, examining research that uses data on interregional transfers and fiscal equalization grants of the countries can point out to significant evidence when studying national and regional inequality levels, since the creation of these transfers and grants will depend on the territorial governance structure of the countries.

One possible alternative argument to this study is that more decentralized communities are also more likely to be homogenous within their own structure and may be more willing to redistribute, utilizing the social and economic capital of their own community. Thus, the theory is tested against this alternative argument whereby decentralized structures could construct their own mechanisms to better tackle with inequality. Furthermore, reverse causality has been shown for redistribution and decentralization, such that income distribution determines constitutional choices in federations (Alesina and Spolaore 2003; Beramendi 2007, 2012; Wibbels 2005). According to these authors, distributional issues form the organizations of fiscal structures, in lieu of fiscal structures paving the way different outcomes. Furthermore, the willingness of the subnational units, the central government or other actors for standardized redistribution – which can lead to lower inequality - is not captured with these models, which sometimes is explained with "political culture".

Also, alternatively, we can look at cases in which granting more powers to subnational actors would decrease inequality within certain regions. One example for a future study would be whether the more power Scotland could get through the devolution process will be associated with less equality for Scotland. Yet, the possibility of lower inequality in that region might also impact the inequality levels among the regions. Therefore, applying the same study by looking at regional inequality levels, and how that in turn impacts national inequality, would open new avenues for research.

The following chapters will allow me to study the self-rule and shared-rule aspects of regional authority, as well the different dimensions of interactive governance in detail, in order to disentangle the relationship between these variables and income inequality.

5.0 THE CASE OF SPAIN: ‘EVOLVING’ AND ‘ACCOMMODATION’ FEDERALISM?

“Spain evolved to a federal form without the proper coordination mechanism needed for a federal system”.[12]

As a country that has been undergoing a substantial process of decentralization in the last forty years, Spain is an appropriate case for testing the theory of this dissertation because: a) it has a unique territorial governance structure with elements of a unitary and a federal state, which has important implications regarding fiscal and social policies that influence income inequality, b) service provision is highly decentralized and c) yet, the governance structure carries both centralized and decentralized characteristics, which are difficult to grasp without understanding how the process of decentralization was created, and how it has progressed. Spain has always had one of the highest levels of national income inequality in Western Europe, with a *Gini* coefficient of 0.347 (out of 1) in 2014, and it has sustained these high inequality levels throughout the years.

In order to test the argument of the dissertation, which examines how and to what extent decentralization and interactive governance significantly impact economic inequality in Spain, this case study examines, 1) a) the official sharing of competences in Spain, b) the political

[12] Personal interview, Madrid, Spain, January 2013.

decentralization and regionalization processes over the years, 2) fiscal and administrative decentralization levels, 3) an overview of the evolution of the welfare state of Spain, 4) recent inequality trends in Spain, and how the territorial governance structure is related to some fiscal and social policies that matter for inequality, 5) the features that make Spain a **low interactive governance** system, looking at its intergovernmental relations, coordination mechanisms and the roles of social actors in issues related to inequality. The qualitative and quantitative data in these five sections of the case study chapter will allow me to evaluate whether the argument of the dissertation applies to this Southern European nation and whether the Spanish case contributes to our understanding of how decentralization impacts inequality.

In this chapter, I use evidence from primary sources such as the Spanish Constitution, elite interviews[13], inequality data from the OECD and the Standardized World Income Inequality Database, secondary sources and quantitative studies on national and regional inequality and fiscal equalization grants to test the theory of the dissertation. For political, administrative and fiscal reasons, which this chapter aims to illuminate, the dichotomies of unitary/federal or centralized / decentralized states do not completely explain Spanish political system. Therefore, it is all the more noteworthy and suitable to analyze the Spanish case by focusing on the importance of this territorial governance structure and how it significantly influences political and fiscal asymmetries, the overall income distribution and economic inequalities in the country.

In my typology of four Western European countries of this study, Spain is in the '*de facto federal state – low- interactive governance* ' category. I classify Spain as a *de facto* federal

[13] Semi-structured elite interviews have been conducted with experts in Madrid and Barcelona in 2013.

state because it neither embodies a unitary nor a federal state in the classic senses of these terms, as I will explain in the following subsection. Spain is the first case I explore in this typology. The case studies of these four countries will be followed by a comparison chapter of the four countries.

5.1 THE SHARING OF COMPETENCES BETWEEN DIFFERENT LEVELS AND POLITICAL DECENTRALIZATION

"The territorial division of Spain is one of the key factors of the current economic and social organization model, and its results and possible reforms play a principal role in the public debate" (Ayala et al. 2009, p. 233).

After the fall of the Franco dictatorship in 1975 following his death, and starting with the Moncloa Pacts of 1977-78 and the 1978 Constitution, Spain gradually underwent a transition from a very unitary and centralized state to a 'constitutionally unitary' but in some ways a '*de facto* federal' one, with both centralized and decentralized organizational features. The Constitution defined Spain as a democratic country, based on rule of law, welfare state and a pluralist society (Colino and del Pino 2011). One of the defining features of the preceding Franco regime was the absolute unity of the governance structure. After Franco died in 1975, political, administrative and fiscal decentralization ensued while the country democratized and developed economically (Moreno and Colino 2010; Agranoff 2010). Until the post-Franco period, the Spanish state resembled the French tradition of two administrative levels: One strong central government and the local level with low levels of autonomy (Requejo 2005), as opposed to having strong regional levels.

As a parliamentary monarchy and a constitutionally unitary country with so-called ‘federal’ arrangements, Spain currently consists of 17 Autonomous Communities – *comunidades autónomas* - (hereafter referred to as ACs or regions (these two terms used interchangeably), created and institutionalized gradually as of the Moncloa Pacts of 1977-1978 - resulting from the bilateral relations between the newly emerging ACs and the central government.[14] There is a three-tiered governance system in Spain, with the central level, the autonomous communities (ACs) and the local governments (including 50 provinces and 8117 municipalities and 10 islands). According to the Spanish Ministry for Finance and Public Administration, the three levels of territorial power are arranged according to the shared competences between these levels rather than hierarchies (Spanish Ministry of Public Administration).

The legislative power in Spain is exercised in *Cortes Generales*, which is made up of two chambers: The Congress of Deputies (*Congreso de los Diputados)* and the Senate (*Senado*), with members elected every four years with proportional representation. The Congress has 350 members directly elected by universal suffrage, where 50 provincial constituencies first have a minimum of two seats, and then the others are allocated based on the proportions of the

[14] These autonomous communities are: *Community of Madrid, Catalonia, Valencian Community, Balearic Islands, Galicia, Basque Country, Navarra, Andalusia, Aragon, Asturias, Canary Islands, Cantabria, Castile-La Mancha, Castile and Leon, Extremadura, La Rioja and Murcia.* Not all of these regions gained autonomy at the same time. For example, the date of signing for the autonomy statutes for La Rioja, Murcia, Valencia, Aragon, Castilla la Mancha, Canary Island was 1982, where for the Balearic Islands, Extremadura, Madrid and Castilla y Leon, this date was 1983 (Hooghe et al. 2010). Also, there are two autonomous cities: Ceuta and Melilla. These two cities participate in autonomous financing according to their Statutes of Autonomy and also the local tax offices’ financing system.

provinces. The Senate has 266 senators: 208 of those are elected by direct universal suffrage. After the 208 deputies of the Senate are selected through the provincial elections, only the remaining 58 deputies are selected by the regions. Gunther, Montero and Botella (2004) call this "*insufficient to offset the resulting representational biases*" (p.120). Furthermore, the Legislative Assemblies of the ACs first appoint one senator, and then one more senator for every million inhabitants of that specific region (The Spanish Government). While the Constitution considers the Senate as a chamber of "territorial representation", many experts dispute this role. The fact that 208 of the 266 members are elected in provincial elections rather than regional parliaments raises flags about how 'regional power' is actually represented at the Senate (Gunther et al. 2004).

The ACs are not granted direct participation at the central level of government and there is no chamber based on *boundaries of the territories*, as the Senate does not have such a capacity (Encarnacion 2008; Moreno 2002, Börzel 2002). The relative weaknesses of the Spanish Senate in politics and the electoral rules for the selection of the deputies to this chamber are elements that contribute to the low interactive nature of governance in Spain, which I argue is associated with more inequality. The absence of a Senate that ensures the representation of territorial interests – despite the fact that the Spanish Constitution (Article 69.1) deems it to do - is one of the shortcomings of the Spanish political system, which was highlighted by the interviewed experts. An interviewee raised the following concern: "*The Senate is like the old second chamber of the centralized system. The system hasn't been solved to formalize the federal aspects.*"[15]

[15] Personal interview, Madrid, Spain, January 2013.

In the Spanish Senate, less populated rural provinces tend to be overrepresented at the expense of more populous regions such as Catalonia, and the majoritarian electoral system is prone to producing majorities in the Senate that reflects the central government. As Gunther et al. (2004) explain, "*The institutional system, as a whole, still suffers from the absence of clear and precise instruments through which regional governments participate in the general policy-making processes*" (p. 333). Also, the Senate lacks veto power and does not really constitute a check on the lower house (Aja 2003). Beramendi (2012) calls the fact that the regions do not formally participate in national legislation production the "*absence of institutionalized co-sovereignty*". After the consolidation of democracy, Spain became a majoritarian democracy especially in the executive-parties dimension, at least until the recent emergence of new political parties in the aftermath of the 2009 economic crisis. The fact that the newly emerging consensus system after democratization in the late 1970s was not fully sustained is also attributed to the weakness of a "consensual political culture" (Hopkin 2005).

During the decentralization process, some autonomous communities were created as 'historical nationalities' (Catalonia, Galicia and the Basque Country), or historical regional entities (the Balearic Islands, Cantabria, Extremadura, La Rioja, Murcia), mainly due to their already existing historical identities. Regions such as Asturias, Castile-La Mancha and Madrid do not have such classifications (Moreno 2001). The first 'pre-regional autonomous body' to be founded was Catalonia (*Generalitat*) in 1977, then the Basque Country in 1978, to be followed by the other ACs.[16] For example, Catalonia's nationhood is not officially recognized in the

[16] Díaz López (1981) explains that while the Basque General Council created by the Royal-Decree Law of January 4, 1978, it could not 'obtain the dissolution of the Basque government in exile'. So it did not have the 'historical legitimacy' of the Generalitat of Catalonia. In 1978, eleven more pre-autonomies were established: Galicia, Canary

Spanish constitution and the "*pace with which the ACs can assume powers and prerogatives*" has been a deciding factor for their autonomy, exemplified in the case of Catalonia, leading the 'state of autonomies' (McRoberts 2001). When the ACs were first being created, the ruling coalition, the Union of Democratic Center (UCD), wanted to establish two types of autonomy: One with full constitutional recognition for Catalonia and the Basque Country and one for the others. However, regions such as Galicia and Andalusia were not on board, and as a result all the ACs obtained the same levels of "constitutional protection" (Beramendi 2012). Furthermore, all the ACs declared themselves as "nationalities" one after the other (McRoberts 2001). However, before the devolution process, only Catalonia, Navarra and the Basque Country actually had "regional governing institutions" (Dudek 2003). Due to these variances among the regions, the democratized Spanish state already started with an unequal political structure, which is an important point in understanding the current territorial governance structure.

The following quote from the official government website sums up how the autonomous system is still in the process of being finalized without an end date in sight: *"The autonomous state is currently in a final stage of maturity and improvement, requiring several years for its culmination"*(The Spanish Government).

Despite the fact that many local governments predate the ACs, the main attention on intergovernmental relations and redistributive concerns in Spain has been on the central government – AC relations (Agranoff and Ramos Gallarín 1997; Agranoff 2010). As one expert expressed in an interview: *"Local governments (municipalities) do not have any power. For that*

Islands and Pais Valencian, Andalusia, Balearic Islands, Extremadura and Castilla- Leon, Asturias, Murcia, Castilla-La Mancha.

reason they are always subordinate. They can only dictate the regulations"[17]. While local governments are important in understanding the variations in the implementation of services, I will focus on the central government – AC relations in this chapter, mainly due to the fact the impacts of decentralization are most visible with regard to the ACs and that that the practice of the AC financing system is illuminating for understanding asymmetries in redistribution, and its impact on inequality. Furthermore, as another expert stated in an interview: "*The system is very decentralized from the point of view of the regions, but not decentralized in local terms. Local governments do not have legislative capacity or [enough] subsidies*".[18]

Spain is made up of peoples with multi-layered identities, including interwoven Spanish, Catalan and Basque identities, among others. Moreno (2001) claims that "*the unequal distribution of resources and power among ethno territorial groups in polities of a plural composition*" proves to be explanatory for the general politics of Spain (p. 17). An interviewee claimed the following: *"Since most of the taxes are collected by the central government, the local politicians do not pay the price of asking more money for their citizens".*[19] This is largely due to the fact different levels of government – local, regional and national - sometimes overlap and intertwine to supply various social services as a result of the ongoing decentralization process.

While ACs are the main political structure that benefit from decentralization, their constitutional status detracts from Spain's classification as an actual federal state. Requejo (2005) lists the characteristics of Spain that distinguish it from regular federations as follows: that ACs are not constitutionally 'constituent entities', legislative powers are not decentralized

[17] Personal interview, Madrid, Spain, January 2013.
[18] Personal interview, Madrid, Spain, January 2013.
[19] Personal interview, Madrid, Spain, January 2013.

in a clear manner, the lack of judicial power of the ACs, and the centralized level of taxation and the non-participation of ACs directly in the constitutional reform processes. Spain has been called a "semi-federal" system (Farrell 2005) or a "quasi-federation" (Agranoff 2004) or a "*de facto* federal state in all but name" (Moreno and Colino 2010), "dual federal" system similar to the US example with the exception of the required fiscal autonomy (Börzel 2002) or a constitutional monarchy that is a "unitary country with most of the features of a federation" (López-Laborda et al. 2007, p. 288). After 1977, demands of autonomy started by specific regions, such as Catalonia, spread to the whole country and this led the way to the transition of a more federal model with asymmetries (Colino 2008; Agranoff 1999). Colino and Kölling (2014) argue that Spain can be classified in the same 'cooperative' or 'integrative' federal category as Germany because the constituent units share powers and revenues with the central government, and the regions in both Spain and Germany have the obligation to implement federal laws and provisions. However, there are other characteristics on which the territorial governance structures and especially the intergovernmental relations diverge in the cases of Germany and Spain that pave the way for different economic outcomes, such as inequality. One interviewee argued: "*Spain and Germany are in the same box for fiscal equalization but Germany seeks to reach it culturally as well… There is a different 'commitment' for redistribution. And there are some unexplained cultural dispositions that distinguish these two countries.*"[20] These different cultural dispositions also stem from the fact that the German nation is more uniform in terms of its political culture, whereas Spain is made up of different identities, such as Catalan or Basque, which contributes to the different dispositions that ask for different types of redistribution. As

[20] Personal interview, Madrid, Spain, January 2013.

Scharpf (2008) states, "*the post-war German polity is a federal state with a unitary political culture*" (p. 510), unlike Spain where "*the concept of dual identity or compound nationality concerns the way in which citizens identify themselves in sub-state minority nations or regions*" (Moreno 2001, p.111). Moreno (2002) also argues that more than two-thirds of people have a "dual" or "compound" identity in Spain, which do not necessarily clash with one another. For example, in the past, even before its ongoing secessionist claims, Catalonia has been regarded as a "region state" due to its booming economy, along with its distinct identity (McRoberts 2001). The idea of an identity, going hand in hand with the industrialization, is also reflected by Moreno (2001): "*Catalanisme built on this 'differential fact' a great deal of their program of demands for home rules, although the perception of distinct origins and national characteristics (cultural, geography, history, law, language, politics and psychology) run parallel*" (p.84).

Spain is associated with certain features of a federal country, with its autonomous communities and devolution to these communities. However, the Spanish Constitution does not allow for a federation, according to Section 145, Article 1: "*Under no circumstances shall a federation of Self-governing Communities be allowed.*" The Constitution does not include specific clauses about the state of the autonomous communities – '*Estado de las Autonomias*'. Therefore, the lawmakers left room for gradual transitions for the future and for devolution to regions to occur, and these devolutions took a bilateral form in many instances (Beramendi 2012). During one interview in Madrid, an expert claimed the following: "*If Catalans do not want the same relationship as the other ACs, this would be a challenge to the Constitution*".[21]

[21] Personal interview, Madrid, Spain, January 2013.

One of the reasons why there is no guaranteed standardization of relationships of the regions with the central government can also be attributed to this bilateral nature of the center – AC relationship. The 1978 Constitution was made possible with the political will and compromises from inter-party discussions (Moreno 2002) and therefore two different tendencies were merged in the 1978 Constitution: "*The indivisible Spain and the Spain of diverse peoples*" (Moreno 2001).

The newly founded Spanish state saw an association between democracy and regional and local autonomy (Colino and del Pino 2011). Section 2 of the 1978 Constitution is titled '**National unity and devolution to nationalities and regions**' and reads as follows: "*The Constitution is based on the indissoluble unity of the Spanish Nation, the common and indivisible homeland of all Spaniards; it recognizes and guarantees the right to self government of the nationalities and regions of which it is composed and the solidarity among them all*."[22]

During the creation of the ACs, some elites in Spain, especially in the military and the Francoist circles, thought that these articles in the new Constitution would lead to the breakdown of the "Spanish nation" (McRoberts 2001). It is argued that the expression of *solidarity* alongside *self-governance* in the Section 2 of the Constitution actually aimed to pacify people who were anxious about the possibility of the disappearance of the unity of the country (Gunther et al. 2004; Sole i Tura 1985). Agranoff (2004) states: "*Spain's well known 'state made up of autonomies' does suggest substantial degrees of rule independent of the center, yet the center's presence is reinforced in the 'indissoluble unity*" *as Article 2 of the Constitution*

[22] The Constitution of Spain, Passed by the *Cortes Generales* in Plenary Meetings of the Congress of Deputies and the Senate Held on October 31, 1978, ratified by Referendum of the Spanish People on December 7, 1978, Sanctioned by His Majesty the King Before the *Cortes Generales* on December 27, 1978.

drives home" (p.31). In the 20th century, Spain was designed as a "centripetal' political union and the main goal of the political system was to limit the influence of regional and identity based parties during the dictatorship (Beramendi 2012). However, after the initial decision to decentralize the major public services, such as health, education, and infrastructure building, political actors also gained more power and gradually started asking for more decentralization. Thus, the extent of decentralization in Spain is also related to political dynamics and the interaction of different actors from different regions that had varying levels of resources before and during democratization.

The eighth part of the Constitution is devoted to the '*territorial organization of the state'*. On this issue, the Section 138 of the Constitution reads as follows:

"*1.The State guarantees the effective implementation of the principle of solidarity proclaimed in section 2 of the Constitution, by endeavoring to establish* ***a fair and adequate economic balance*** *between the different areas of the Spanish territory and taking into special consideration the circumstances pertaining to those which are islands.*

2. Differences between Statutes of the different Self-governing Communities may in no case imply economic or social privileges."

As interviewed experts' opinions and results from extant quantitative studies, which I will elaborate on in the next sections of this chapter demonstrate, the aims of solidarity and a fair and economic balance stipulated in Article 1 and 2 of Section 138 of the Constitution are not always achieved to the desired extent. The fiscal and economic asymmetry that has since emerged in Spain has some of its roots in the already existing imbalances in the country at that time: Francoist elites and the military favored a more central state, while the nationalist movements in Catalonia, Basque Country asked for more decentralization of the state. In this regard, understanding the history of the foundation of the Spanish state after the transition to democracy is a crucial step for understanding why the territorial governance structure matters for inequality (Beramendi 2012). The centralist tendencies in Spain that had existed during the Franco leadership were regarded to have been a legacy of the Jacobin practices of France that were advocated by the liberals in Spain during the nineteenth century, where the notions of "state" and the "central government" were synonymous (Moreno 2001). Therefore, the transition to democracy stressed the delicate balance between achieving solidarity and recognizing the various differences in Spain. In the early years of *the State of Autonomies*, Díaz López (1981) wrote the following about the Chapter 8 of the Constitution, which foresees the persistence of the regional differences:

"*It has been said that Title VIII of the constitutional text which defines the territorial organization of the state is the most original and innovative of the entire Spanish constitution. The fact that it accepts the differences among the varying communities as a positive and enriching feature, worth protection and stimulation, initiates a break with the centralist and homogenizing model of the former authoritarian regime*" (p. 203).

The regional disparities in Spain did not originate during Franco's reign. Going further back in time, how did the variations in Spain seem to the earlier in the 20th century? According to the Spanish philosopher Ortega y Gasset, "*Spain is today not so much a nation as a series of water-tight compartments*" (1921). Due to the history of its regionalization, the 'heterogeneous' Spain has been of scholarly interest for a long time. In their classic work '*The Eight Spains*', Linz and de Miguel (1968) explain seven different types of provinces in Spain, plus the metropolitan area of Madrid, based on differences of economic and social structure, long before the official creation of the ACs. These are: *1) Bourgeois (industrial) Spain* with centers in

Barcelona in Catalonia, Bilboa and Guipuzcoa in the Basque Country[23], *2) Proletarian in transition*, where there exist a similar proportion of middle class as the first category but with more unskilled works, giving the example of the city of Cadiz, 3) *Clases medias* in transition, refers to cities predominantly with populations between the bourgeois and middle classes that do not have a lot of proletariat and a certain level of industrialization, such as the less industrial provinces of Catalonia, Zaragoza and 'emerging industrial center halfway between Barcelona, Bilbao and Madrid'. 4) *Clases medias*, referring to the interior Spain with the center in Castile with traditional landowners and peasantry. Also the medium sized cities are industrialized to some extent, and are mostly inhabited by professionals, merchants and civil servants. The authors refer to this part of the country as the most 'traditional' Spain, with some of the population deriving its income from the land. Another important thing they note is that this region is more 'integrated' within itself compared to other parts of Spain and therefore there are no significant regional inequalities. Here, Madrid was the official establishment and the residence of nobility and intellectuality. *5) Gentry in transition in Spain*, where farm laborers earned more money than the national average. Valencia was given as an example with a commercial agriculture and growing industry. *6) Gentry Spain* refers to the social structure with dominance of social workers and farm laborers. The cities do not have modern industry or skilled workers. Agricultural towns in Andalusia and Extremadura are some examples with dominance of this class structure. 7) *Proletarian Spain*: They refer to specifically two provinces: Huelve and Cordoba which are surrounded by gentry provinces. There is a big population employed in mining and the capital cities are close to the metropolis of Seville. The authors also

[23] Catalonia and Basque Country are still the regions that are asking for more autonomy and fiscal differentiation from the central government. Furthermore, Basque Country is not included in the central government's general tax regime for the ACs, along with Navarra (sometimes referred to as Navarre), as will be explained later in the chapter.

point out that 'bourgeois Spain' at that time had a per capita income 31 percent above the national average. Therefore, even before the creation of the ACs, the regional economic and social differences had already been established due to the existing economic structure and the various socioeconomic classes that were dispersed throughout the country.

This classic division of the country into 'eight' different *Spains* has not directly translated to the same divisions of borders of the ACs. Yet, the division of Spain into eight different parts shows that the unequal 'regional' rationale existed in Spain long before the official creation of ACs starting at the end of 1970s. The 'first' Spain, as referred to in this classic work, is the '*Bourgeois'* Spain, which includes regions such as Catalonia and the Basque Country, which are still among the most affluent regions in Spain. As Moreno (2001) states, "*The industrial expansion of Catalonia started with the "capital accumulation brought about by agricultural production and colonial trade with the Americas during the second half of the eighteenth century*" (p.83). Moreno (2001) argues that the existing 'non-congruence' has facilitated the 'centrifugal' tendencies in Spain, which are still reflected in both the central government's redistributive practices and the economic capabilities of the regions. The varying pace of industrialization in Spain, especially in Catalonia and the Basque Country, and sociocultural differences also gave rise to different regionalisms. Moreno (2002) states: "*Catalonia and the Basque Country, the two northern peripheral Spanish communities with full ethnic/cultural potential, have remained as two of the three economically most dynamic territories of Spain, the third being the region of Madrid. This non-congruence has traditionally nourished the* ***centrifugal*** *tendencies present in modern Spanish history*" (p.399). So, the creation of the economic and political geographical structure also depended on these differences that existed in the first place (Colino and del Pino 2011), and we see a move from a centripetal to a centrifugal structure. The variations among the regions have accompanied the creation process of this decentralized system from the beginning. At the same time, the centrifugal tendencies that fed from the disparities sustain and contribute to the furthering of some regional differences throughout the country, which I will elaborate on when discussing regional inequality levels in Spain. The uneven regional economic development facilitated this asymmetry, and the setup of the territorial structure contributed to the already existing inequalities throughout the country. According to an expert, "*The system is not actually fit to contain diversity. But it should, because it is unitary and decentralized* [at the same time]."[24]

In short, understanding the legacy of the territorial governance structure is important for understanding the causal mechanism between decentralization and inequality, because the historical legacies and the efforts in reviving the decentralized structure after democratization cannot be overlooked, when studying the dynamic impact of the decentralization process on inequality. Based on this foundation, next, I look at how the different types of decentralization processes unfolded in Spain after democratization, in order to tease out their significant impacts.

5.2 FISCAL AND ADMINISTRATIVE DECENTRALIZATION IN SPAIN

In general terms, Spain is a highly decentralized country in terms of the *provision* of services to citizens, with most of the power of *delivery* of services resting in the autonomous communities (ACs) in services such as education, tourism, transport, culture and healthcare; a point I will return to when talking about the welfare state. Therefore, the administrative decentralization

[24] Personal interview, Madrid, Spain, January 2013.

feeds from the decisions that have brought about the political decentralization. The local – central government relations gradually moved towards more regional discretion in Spain (Wannop 1997). The sectors that have been given the most priority by the ACs are health, culture, education, linguistics and mass media policies (Giner and Moreno 1990; Moreno 2001).

5.2.1 Different periods of the decentralization processes in Spain and quantitative indicators: Regional Authority Index

As expressed in the personal interviews and in the literature, the *de facto* federal governance structure of Spain and the levels of decentralization are of 'evolving' nature, prone to changes concerning the power structure between the central government and the ACs. Powers have been devolved to the ACs gradually and some of them were on a 'fast track' in gaining more powers (such as the historical nationalities of Catalonia, Basque Country and Galicia, and Andalusia having special needs) – on a demand basis - whereas other ACs took more time to get powers in taxes and public services. Gunther et al. (2004) argue that this goes counter to the classic federal theory put forward by Elazar (1987) or Riker (1964) where regional representatives would all engage in one type of negotiations with the central state. The decentralization process went through different stages of 'bilateral negotiations' between the central government and the ACs (Gunther and Montero 2009; Moreno, 2001). The Italian model influenced the 1978 Constitution in terms of the two-track nature of the ACs (Loughlin and Peters 1997). As of the 1980s, the competences of regions have shifted more towards development policies pertaining to their own regions and regional welfare policies. Before the autonomous status was granted to the regions, all the ACs negotiated their statute – similar to a "jurisdictional constitution" (Agranoff

2004). Each AC has an elected parliament, a president and a cabinet, along with their own administrative bodies. An interviewee pointed out to the importance of legacies in the decentralization process: "*Basque Country and Navarra, they collect all their taxes and they decide on the common services, as well as defense and foreign affairs. Since the Middle Ages, they had this agreement*".[25]

The articles 148 and 149 of the Spanish Constitution specify which jurisdictions (either central state or the autonomous communities) specific policies fall under. According to Article 148, **the promotion of economic development of the Self-governing Community within the objectives set by national economic policy and social assistance and town and country planning and housing** are devolved to the ACs.[26] The fact that they have many competences in areas such as policing, health and education make ACs "*more powerful than any other subnational government structure in Europe*" according to Gunther et al. (2004), despite the fact that the Constitution does not allow for an actual federation. According to Article 149, the following are the exclusive competencies of the central state:

- **Regulation of basic conditions guaranteeing the equality of all Spaniards in the exercise of their rights and in the fulfilment of their constitutional duties**.
- Nationality, immigration, emigration, status of aliens, and right of asylum.
- International relations.
- Defense and the Armed Forces.
- Administration of Justice.
- Commercial, criminal and penitentiary legislation;
- Basic rules and coordination of general economic planning.
- General financial affairs and State debt.

[25] Personal interview, Madrid, Spain, January 2013.
[26] Some of the other policies that are exclusively under central jurisdiction, according to Article 149, are: Public works of interest in their territory, railways and roads within their territory, ports of haven, recreational ports and airports and in general those not engaging in commercial activities, agriculture and livestock raising (in accordance with general economic planning), woodlands and forestry, management of environmental protection planning, the promotion of culture and research, the promotion of tourism within its area, health and hygiene.

- Promotion and general coordination of scientific and technical research
- Basic legislation and financial system of Social Security, without prejudice to implementation of its services by the Self-governing Communities.
- Basic rules of the legal system of Public Administrations and the status of their officials

Spain exemplifies the complications of finding a complex balance between the self-rule and shared-rule components of Elazar's federalism concept (1987), due to the centralized yet asymmetric and non-interactive nature of redistribution, in line with the theory of this work.[27] For example, while the (central) state has to make sure that there is a certain minimum standard in healthcare or education in the ACs, the ACs can implement these services differently, indicating administrative decentralization. The areas are under **concurrent** state and AC jurisdiction are **health, education, administrative law and the environmental protection**, meaning that the State legislates the main guidelines for national standards, and ACs both legislate and implement according to these guidelines (Beramendi 2012).

The competences of the ACs have increased as a result of decentralization, mainly in matters of public expenditure and taxes. For example, their regulatory capacities in income tax or income guarantee schemes have partially increased, and they have full competences in the general income guarantee schemes, meaning that they have "*a certain margin to modulate the relationships between economic growth and poverty in their territory*" (Ayala and Jurado 2011, p. 105). The quantitative chapter of the dissertation used each country's aggregated (national) scores of the *Regional Authority Index* (RAI) in the statistical analysis of OECD countries, showing a significant relationship between fiscal decentralization and national income

[27] This is based on data from interviews with experts and author's own elaboration. Interviews were conducted with experts at Complutense University of Madrid, The Autonomous University of Madrid, National University of Distance Education, Spain and the University of Barcelona, Institut d'Economia de Barcelona.

inequality. Looking at Spain's RAI scores, we can see that Spain's aggregated score for the self-rule of its Autonomous Communities overall increased from 9 in 1982 to 13 in 1983 - 1996 to 14 1997 – 2010.[28] These scores are made up of the addition of the *institutional depth, policy scope, fiscal autonomy, borrowing autonomy and representation* scores of the regions. Concerning shared-rule, the aggregated scores have gradually increased as well. In 1982 – 1986, the aggregated shared-rule score was 6.5, while it became 8.5 in the subsequent period of 1987 – 2001, and 9.5 in the period of 2002 – 2010. Therefore, we also see an increase in the shared-rule of the regions in Spain.

Among the scores for the variables that constitute the self-rule aspect of the RAI, *institutional depth and policy scope* have remained the same from the first date of the creation of the regions (about 1978) until 2006, both with a score of 3.0.[29] On the other hand, the *fiscal autonomy and representation* scores have all increased for the regions of *Basque Country, Catalonia, Galicia, Andalusia, Navarra, Asturias and Cantabria* (Hooghe et al. 2010). The overall *representation* score also increased from 0 in the first period to 4.0 in the subsequent periods. This score is a combination of scores of both the assemblies and the executives of the regions. With a score of 2 out of 2 for both the regional assemblies and executives, it is indicated that they have directly elected assemblies and regional executives either appointed by the regional assembly or directly elected. Self-representation score is at the highest possible score in this case, showing the representative autonomy in self-rule.

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[28] Higher scores show more authority for the regions for each of the variables. A higher overall RAI score indicates more decentralization.

[29] From the Regional Authority Index: A score of 3.0 for institutional depth means: A non-deconcentrated, general-purpose administration not subject to central government veto. A score of 3.0 for policy scope means: The regional government meets the criteria for 2 and is endowed with at least two of the following: Residual powers, regional police force, authority over own institutional set-up, authority over local government.

The aggregated scores of *fiscal autonomy* of the ACs as a whole have gradually increased from 2.0 for the period 1983 – 1996 to 3.0 (out of 4.0) in 1997 – 2006, meaning that on the whole ACs have moved from setting *the base and rate of minor taxes* to *setting the rate of at least one major tax*: *personal income, corporate, value added or sales tax.* The different autonomous communities in Spain also have varying fiscal authority scores, indicating unevenness, fiscal asymmetry and the bilateral nature of decentralization. For example, Navarra and Basque Country's *fiscal autonomy* scores are both 4.0 as they are outside the general tax scheme – which will be explained subsequently. This score indicates that Navarra and the Basque Country can '*set the base and rate of at least one major tax: personal income, corporate, value added, or sales tax.*" As categorized by Novo Arbona, Pérez Castaños and García Rabadán (2016), the period of 1980 – 1986 corresponded to a general increase in fiscal decentralization, and fiscal decentralization was finalized in the period of 1987 – 1991 with the harmonization of transfers and taxes. Afterwards, until 1996, the other regions, namely the "slow-track" ones also gained new competencies, including the fiscal decentralization. In the RAI index, after 1996, the score increases to 3.0. Again, this increase in the score can be attributed to the fact that regions also gained legislative competencies for taxes and some parts of the VAT in the post-1996 period (Novo Arbona et al. 2016).

Borrowing autonomy, as another indicator of fiscal decentralization gets a score of 1.0 (out of 3) in all the periods. This means that, as of 1980, which is when this statute was first adopted, the ACs can issue debt with getting authorization from the central government first (ex ante). The only exception to this is when ACs are borrowing credit for less than one year.

Concerning *representation* within self-rule, the ACs have moved from having no assembly in 1982 (score 0) to a score of 4.0 in the following period, meaning that they have directly elected assemblies and regional executives appointed by a regional assembly or directly elected. This change shows a clear departure from the previous centralized structure towards a more decentralized system.

Below I present a table and a chart demonstrating how the scores have changed or remained the same in different periods after they gained autonomy for Spain's ACs. In the case of Spain, the self-rule variables contribute to the overall RAI score much more than the shared-rule variables, which I explain subsequently. This is also an indication of the low interactive nature of governance in Spain.

Table 7. Self-Rule and Shared-Rule Dimensions of the Regional Authority Index in Spain

Self-Rule Dimensions

Autonomous Communities	**1982**	**1983 - 1996**	**1997 – 2010**
Institutional depth	3.0	3.0	3.0
Policy scope	3.0	3.0	3.0
Fiscal autonomy	2.0	2.0	3.0
Borrowing autonomy	1.0	1.0	1.0
Representation	0.0	4.0	4.0
Aggregated self-rule:	**9.0**	**13.0**	**14.0**

Shared-Rule Dimensions

Autonomous Communities	**1982 - 1986**	**1987 - 2001**	**2002 - 2010**
Law making	0.5	0.5	0.5
Executive control	0.0	2.0	2.0
Fiscal control	1.0	1.0	1.0
Borrowing control	1.0	1.0	2.0
Constitutional reform	4.0	4.0	4.0
Aggregated shared-rule:	**6.5**	**8.5**	**9.5**

The **'shared rule'** variables– which are the interactive components of RAI, - *law making, executive control, fiscal control, borrowing control or constitutional reform* - some scores remained the same while the others changed.

The **fiscal control** score for all the regions reported above has also remained the same, at 1, which, on a scale of 0 to 2, indicates: "*regional governments or their representatives in the legislature negotiate over the distribution of tax revenues but do not have a veto*". This fact is the first evidence showing that there has not been an increase in the **interactive** governance, concerning fiscal matters, as I specified more interactive governance with more fiscal control in the theory chapter. Since 2011, regions can vary the income tax rate and the bands different regions have done so. For example, Catalonia taxes its citizens earning more than 150,000 Euros at 49 percent, while Andalusia will apply the 49 percent income tax rate for citizens earning more than 120,000 Euros. In contrast, the tax rate of Madrid starts at 19.5 to a maximum of 44.5 percent. Asturias taxes its citizens at 48.5 percent, and Cantabria and Extremadura tax them at 48 percent (Tax Agency of Spain 2016). The RAI scores and the tax rate variation among the regions point out to an overall trend of increasing fiscal autonomy, but there is not enough evidence for the increase of *fiscal control* for the ACs, which would mean shared rule on tax affairs with the central government.

The *borrowing control* level of the ACs has also increased from the first period to the next ones. Since 2006, the ACs have been under stricter control concerning their fiscal restoration. The multilateral **Fiscal and Financial Policy Council** executes the overall coordination of the public debt of the ACs. Their score was 1.0 in the period before 1980, and after 2002 they score 2 in borrowing control mainly due to the multilateral nature of borrowing. The score of 1 indicates that regional governments can negotiate over borrowing constraints routinely without a veto, and the score of 2 indicates that they have veto power as well (Hooghe et al. 2016).

During the process of fiscal decentralization, the ACs have been given more autonomy over collection of certain taxes, as will be explained in the subsequent sections. However, this level of autonomy does not have high revenue-raising potential for the ACs, which would come from property taxes, real estate sales taxes, gambling taxes or inheritance taxes (Herrero-Alcalde et al. 2011). Furthermore, reliance on central government grants led to further competition among the regions, adding to the more centrifugal and less interactive nature of the relations. Another decentralized characteristic of Spain is that local civil servants earn different amounts of salaries in different ACs of the country, however the differences are not high enough to promote mobility between the regions. An interviewed administrative law expert stated the following: "*[In Spain], you cannot decentralize on capital earnings, because that would violate standardization and create mobility. But you can decentralize work earnings. So this means mobility for people and not for capital*." [30] This point is important for understanding the type of decentralization being created in Spain, which centers on income rather than capital, paving the way for income differences.

Despite recent moves toward more variation in the regional tax rates, Colino and Kölling (2014) explain why the ACs do not have incentives for getting more fiscal autonomy, as regional taxes do not create sources of revenue:

"*Financial arrangements in Spain evolved from a system based on* ***centralized tax collection*** *and* ***conditional transfers*** *to a system that increasingly relies on regional own source tax revenues, revenue-sharing and some* ***unconditional equalization grants****. However, regional*

[30] Personal interview, Madrid, Spain, January 2013.

taxes are ***heavily regulated*** *and* ***inflexible****. These funding arrangements have been criticized for the lack of revenue autonomy for the units, the lack of accountability of regional governments and of clear distributive criteria for the equalization mechanisms*" (p.5).

Spain is considered as the only OECD country that has significantly increased its both revenue and expenditure side of fiscal decentralization (Biela et al. 2013). This also corresponds to the increase in the *fiscal autonomy* scores of RAI. However, the revenue side is not decentralized enough to give full decision-making power or the fiscal capacity to the ACs, and expenditures have decentralized to a much larger extent (Beramendi 2012). As one expert also claimed in the interviews, *"Spain is decentralized in terms of expenses (expenditures) of its regions but centralized in terms of its revenues. In other words, the ACs can spend their own money and provide basic services like education, housing and health, however their revenues for these services largely depend on how much the central government provides to them, which is not always the desired amount"*[31]. This point constitutes the core of the "territorial imbalance" that also leads to the asymmetries in the centralized nature of redistribution, which will be explained in the next subsection with the topic of fiscal flows. Beramendi (2012) also notes that the process of decentralization especially manifested itself with expenditures, but this did not translate to higher power for the ACs to collect their own revenues. The ACs have gained powers for development of infrastructure, education and health and starting to spend more in these realms, as he argues:

"The combined effect of service provision decentralization, the increase in transfers to regions, and the centralized nature of income transfers generates very high levels of redistribution across territories in Spain. ***The fiscal flows of public expenditure in general, and social security in particular, generate significant redistributive effects across regions****. These flows shape Spain's geography of income inequality and nurture distributive tensions between*

[31] Personal interview, Madrid, Spain, January 2013.

those parties and regions benefiting from the status quo and those parties and regions that feel unduly exploited by an excessively centralized fiscal structure" (p. 185).

The *administrative* decentralization in Spain rests on territorial arrangements to a large extent. Arenilla Saez (1999) argues that the central government created an "organic design space" to achieve the territorial and social integration of the state which involves the administrative order of different levels of power. He states that "*the origin of the principle of centralization is linked to that of equality, rationality, the legality, the solidarity, the unity of power and its action and the uniform social ordination*" (p.96-97). If all the layers are interwoven organically, this also requires a natural flow of coordination between different layers of power, which does not yet exist in Spain. The idea of full centralization promoted during the Franco period has gradually transformed with democratization, and the need to balance the asymmetrical decentralization while allegedly maintaining the principles of centralization has been a challenge for the Spanish state. In general, it is argued that the central state can legislate without full participation from the ACs, whereas the ACs have the authority to implement the decisions without the intervention of the central government (Börzel 2002).

In terms of the number of laws legislated, the ACs also show a great difference. In the period 1980-2010, Navarra has legislated 612 laws, whereas Madrid has legislated 345 and Catalonia has legislated 612 and the Basque Country has legislated 324. Also it is important to note the numbers of legislated laws have decreased in the recent years mainly because of the New Organic Law that proposed the formalization of previous accords (2010). The differences in the numbers of laws legislated also stem from the fact regions can pass their own laws while the law of the land, (*Lei de Basis*) has to be respected in whole Spain.

As far as administrative decentralization is concerned, Spain's entry to the European Community (EC) in 1986 necessitated an alignment of its regional policies with that of the EC's, and the role of the ACs in the implementation of these policies became a crucial element in the realignment of territorial organization of power in Spain, or as Dudek (2003) calls it "institutional adaption" (p. 113). During the first year of Spain's entry to the EC, the central government received the EC funding, which was a point of contention between the central government and the ACs (Bache and Jones 2000). Until the major 1988 reforms of the European Regional Development Fund (ERDF), the central government mainly coordinated the implementation of regional policies, a point after which the participation of eligible regions, such as Andalusia, increased in the process and more multilateral collaboration started, despite some complaints from Navarra, Catalonia and Basque Country about funding allocation (Bache 2008; Bache and Jones 2000). Nevertheless, the central government was the main point of contact with the European Commission, and the main decisions were taken between these two institutions, which were then implemented by the ACs. Gradually, the links between the ACs and the European Community (which subsequently became the EU) increased, with the ACs participating more in the devising of regional plans, especially after 1993. The ACs opened representative offices in Brussels at different times, the first one being the office of Catalonia, even before the entry of Spain into the EC (Morata and Popartan 2008). Again, the relationships with the European level has led to an increase in the administrative decentralization of Spain in general throughout the 1990s and a push for more regionalization (Bache 2008; Marks 1996), which needs to be taken into account when considering the link between decentralization and inequality. As Bache (2008) states, the increase of the roles of the regions came at the expense of the roles of local governments and social actors in the management of the ERDF expenditure but overall the EU regional policies were "absorbed" in Spain, rather than the policies leading to a transformation in the governance structure.

How does all of this relate to the argument of the dissertation? This section provided qualitative and quantitative evidence on the political, administrative and fiscal decentralization in Spain, in order to contribute to our understanding of the furthering of the decentralization process in Spain. As explained, Spain has become more decentralized following its democratization and the scores of the self-rule variables that make up the *Regional Authority Index,* such as *institutional depth, policy scope* have remained quite high. As far as the self-representation of the ACs is concerned, there has been an increase after 1980 as well. Yet, what does this mean for inequality? For this purpose, it is important to analyze the fiscal self-rule and the fiscal shared-rule in more detail, because fiscal powers are more determining for inequality, as the theory of this work shows.

Therefore, one needs to understand Spain's fiscal and social policies in the following section, in order to understand the whole picture to test the theory of the dissertation. The increased and the high scores of the self-rule variable of *fiscal autonomy*, has not been matched with the shared-rule side of fiscal decentralization, which I measure with *fiscal control*. Furthermore, as I explain in the following section of this chapter, the redistributive fiscal flows are very centralized, which complicates the nature of the AC – center relationship. Therefore, looking just at the RAI scores is not conclusive, but I will go back to these scores after looking at the inequality levels. As the theory suggests, is more decentralization significantly associated with more inequality in Spain? In order to answer this question, it is necessary to look at some of the fiscal and social policies impacted by decentralization. For a further understanding of this link, I now turn to explaining the evolution of the welfare state in Spain, followed by a look at the fiscal and social policies.

5.3 EVOLUTION OF THE WELFARE STATE IN SPAIN

To assess the association between decentralization and Spain's inequality for applying the theory of this dissertation, understanding the creation and the evolution of its welfare state is crucial, because the causal mechanism between fiscal autonomy and more inequality goes through the channel of welfare state policies, as explained in the theory section. Considered as a Mediterranean – or Southern European - welfare state regime, Spain's welfare policies, such its overall social spending and pension system are usually categorized with those of other countries such as Greece, Italy and Portugal. According to Hemerijck's (2013) classification, Southern welfare regimes are characterized by job market insider-biased entitlements, differentiation and preservation of one's insider / outsider status in the labor market, extended family as welfare provider, full male employment, focusing on the maintenance of income and collective responsibility (p. 161). Spain is one of the countries in Europe, where the difference between the labor market insiders and outsiders are noticeable to a great extent, as it is in France, exhibiting a dualist welfare state. A dualist welfare state is where the wages and the benefits of those employed and those that are not employed, or those employed in part-time jobs can clearly be distinguished. As Moreno (2009) argues, the welfare state regime of Spain does not exactly fall into one of the three categories of Esping-Andersen's (1990) three worlds of welfare regimes, largely due to the changes from democratization and decentralization altering the configuration of the welfare state, such as the provision of universal healthcare, education, social care and other service policies (Hemerijck 2013). The Spanish welfare state can be considered “a middle way” welfare state (Rodriguez Cabrero 2011; Moreno 2001), which is a type that needs to respond to both the labor market pressures and the citizen demands.

The creation of the welfare state, in terms of social insurance, dates to the early 1940s in Spain. Very low social services were available during the Franco era and there were old age pensions, maternity services, occupational injury insurance and disability insurance, which relied on contributions by workers. Low levels of protection and partial coverage of the population were the main features of the authoritarian welfare state regime before democratization. This changed with the influence of the corporatist National Movement, which increased social security (Gunther et al. 2004). However, bilateral decisions between different ministries prevailed and there were no formal or informal groups outside the state administration that played a role, with the ultimate authority residing in Franco. *The Cortes* was regarded as a **quasi-corporatist** parliament (Gunther et al. 2004). Due to the Francoist regime, welfare state modernization arrived later than other continental European states, and this is argued to have contributed to the prevalent insider / outsider divide as well (Hemerijck 2013). Some characteristics of the Franco regime were the banning of the representative trade unions and the existence of vertical syndicates with bureaucracies linked to the party members. Also, the hierarchical and patrimonial social order was emphasized within the Catholic tradition (Giner and Sevilla 1984). Nevertheless, the 1960s witnessed some developments of the welfare state, especially in 1963, the year of the First Social Security Act. As Rodriguez Cabrero (2011) explains, the main forces that shaped and consolidated the welfare state in Spain upon democratization were the creation of political democracy, the “social-democratization”, decentralization and Europeanization of social policies especially in the 1980s with Spain’s entry to the EC in 1986 (p.17). Spain was lacking social assistance schemes until the late 1980s. Spain’s entry to the European Economic and Monetary Union also necessitated the restricting of the pension reforms in the 1990s (Ferrera 2010).

Overall, despite the decentralization process, the current Spanish welfare state is quite centralized with an emphasis on centralized social security and redistribution - closer to a *Bismarckian* model – (Rodriguez Cabrero 2011). The health services and education are linked to the labor market, and are associated with features of a social-democratic welfare state, managed and implemented by the regional governments. Contributory pension benefits has had high replacement rates in the Southern European countries including Spain, but at the same time the benefits for those outside the job market (in other words, outsiders, including unemployed and poor) were actually the lowest, according to 1999 figures, again indicating the insider / outsider divide (Ferrera 2010). However, social benefits were increased and made more universal, especially with means-tested minimum income schemes (at the central and regional level), family benefits and social services, and with the increase of public-private partnerships.

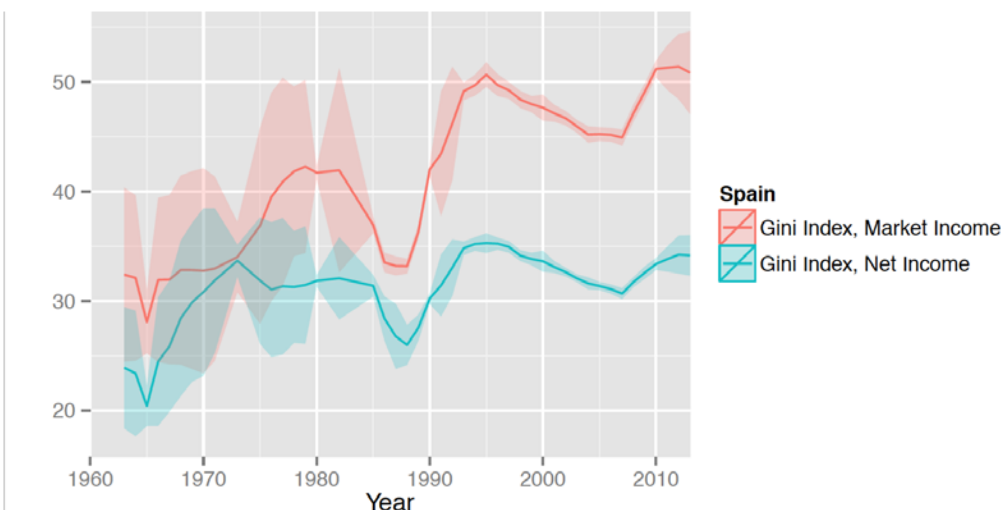
Based on the background information on the welfare state, I now look at the national and regional inequality levels in Spain before analyzing the specific link between decentralization and inequality. Then, I turn to the subnational financing system and fiscal and social policies in Spain, focusing on how the territorial governance structure impacts the way they are determined or funded or implemented.

5.4 INEQUALITY TRENDS AND FISCAL AND SOCIAL POLICIES RELATED TO DECENTRALIZATION IN SPAIN

5.4.1 Spain's national inequality levels

Before looking at the fiscal and social policies that matter for inequality in the next section, I first provide an overview of the national inequality trends, as well as some regional inequality figures. **Figure 2** below displays the fluctuation of the **net income inequality levels** (after taxes and transfers) and of the **market income inequality levels** (before taxes and transfers) in Spain according to the Standardized World Income Inequality Database (Solt 2016) for the years that I cover in the statistical study of this work (1960 onwards). This chart shows how much taxes and transfers effectively had an impact on the inequality levels in Spain, usually decreasing inequality about 15 percentage points, which is lower than, e.g. France, where the redistributive policies resulted in, on average, about a 20 percentage point difference. In the beginning of the time period, the net inequality is just below 0.25 (out of 1) while it is nearing 0.3 at the end of the time period.

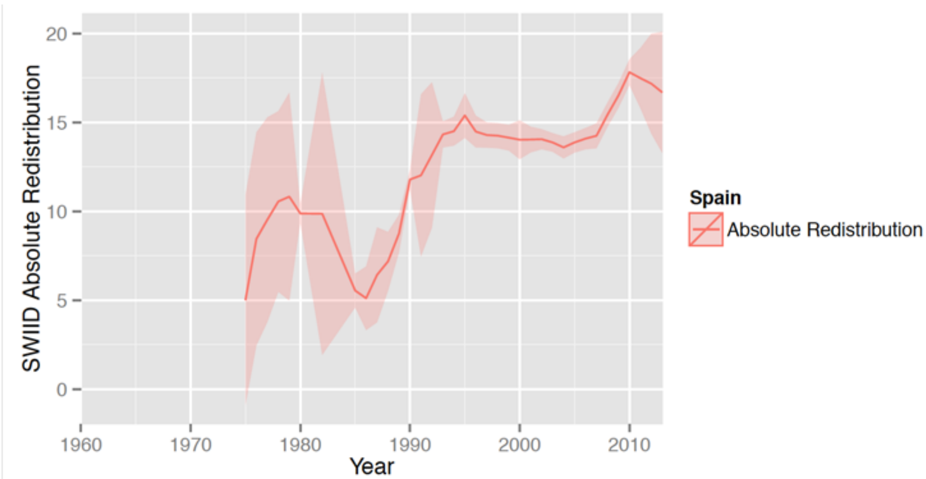
Figure 3 shows the absolute redistribution in Spain according to the World Income Inequality Database, which is found by subtracting net income inequality from market income inequality. After increasing gradually as of the second half of the 1970s with the democratization process, there was a downward trajectory of the amount of redistribution in the first half of the 1980s. It then increased gradually until the early 1990s, followed quite a straight path, and then increased again in the latter parts of the 2000s, before decreasing after 2010 with the economic crisis.[32] The 1993 economic recession is marked as an important turning point for increases in inequality (Ferrer-i-Carbonell et al. 2014). Also, the relative redistribution (market-income inequality minus net-income inequality, divided by market-income inequality) showed a similar pattern, but overall, increases in redistribution and the redistributive processes that aimed at further fiscal equalization among the regions did not remove Spain from the high-inequality (national level) country category in the OECD. Furthermore, in the periods where market income inequality increased, the net redistribution was not on the increase. One can argue that if redistribution were on the increase at those times, this could have contributed to lower net income inequality.



Note: Solid lines indicate mean estimates; shaded regions indicate the associated 95% confidence intervals.
Source: Standardized World Income Inequality Database v5.0 (Solt 2014).

Figure 2. National Income Inequality Levels of Spain

[32] It is important to note that the inequality trends in Spain need to be dealt with cautiously because Spain does not have "coherent data sets" for the 1980 and 2010 period and there are 5 different data sets. Since Spanish inequality data are not reliable, the income equalization period, which some claim goes on until 1993, was due to wage compression and more progressive tax and benefits system (Ferrer-i Carbonell et al. 2014).



Note: Solid lines indicate mean estimates; shaded regions indicate the associated 95% confidence intervals.
Source: Standardized World Income Inequality Database v5.0 (Solt 2014).

Figure 3. Absolute Redistribution in Spain (Market Income Inequality minus Net Income Inequality)

As **Figure 4** shows below, according to 2012 figures, Spain ranks as a high inequality country compared to many other OECD countries based on its household net income inequality levels. Among the OECD countries, Estonia, Portugal, Greece, United Kingdom, Israel, United States, Turkey and Mexico surpass Spain with their higher inequality levels. According to Atkinson's (2015) classification, overall inequality in Spain has risen close 4 percentage points since 1980, slightly above the "salience criterion" level, higher than Germany and definitely higher than France where inequality decreased (p. 81). Among the four cases of this dissertation, Spain exhibits the highest income inequality, followed by France, which are the two low interactive governance countries. On the other hand, the higher interactive governance countries – Germany and Sweden – have lower inequality levels.

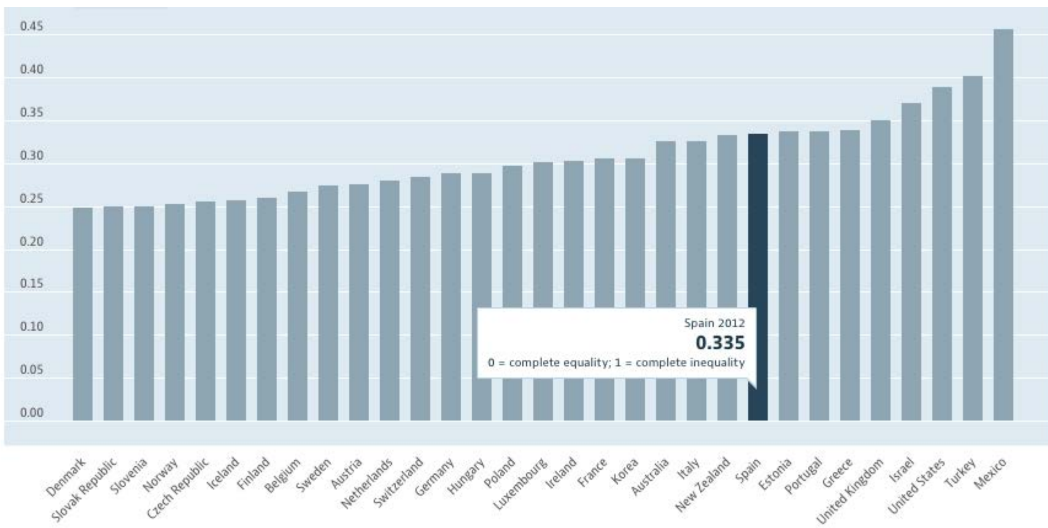


Figure 4. National Income Inequality in the OECD Countries and in Spain, Gini levels, 2012

Source: OECD (2016)

As indicated in the theoretical chapter, there are other measures of inequality in addition to the *Gini* index. For example, Spain's income polarization is evident in the fact that the percentage of those that fall in the 'middle class' has shrunk 7.1 percent between 1980 and 2000, according to a study by Pressman (2007). The share of top 1 percent in the total income in Spain is currently about 8.2 percent (Alvaredo, Atkinson, Piketty, Saez and Zucman 2016). According to the OECD (2011), between 1990 and 2005, the share of the top 1 percent of incomes increased only slightly in Spain, from 8.4 percent to 8.8 percent, which was an increase lower than that of English speaking countries. The earnings of the **top decile (P10**), measured as a percentage of **median income (P50)** amounted to about 2.40 times of the median income in 2012, which is one of the highest in the OECD, as displayed in **Figure 5** below. However, the gap between the wages of the best-paid workers and the lowest paid did see a one fifth decrease between 1994 and 2008, while it increased in other places in the OECD, indicating a move towards less inequality with regard to that specific measure (OECD 2011).

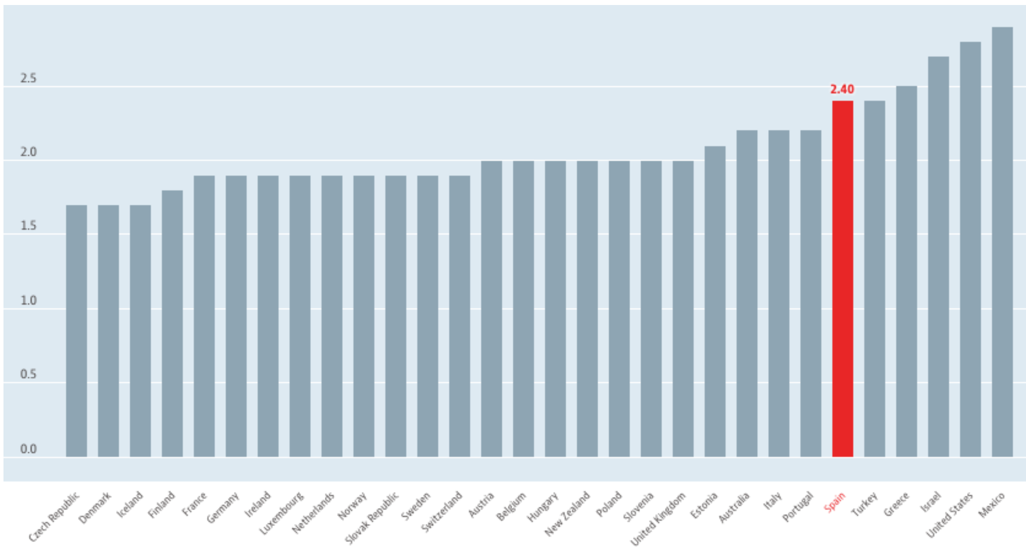


Figure 5. National Income Inequality Inter-decile P10/P50 Ratio, 2012

Source: OECD (2016)

Despite the fact that Spain has high national inequality, it also exhibits strong redistribution from services: According to the OECD, public services in Spain contribute to the decreasing of income inequality by close to one-fifth, as in most other OECD countries, and even slightly higher. Yet, to reiterate, this redistribution was not strong enough to remove Spain from the high-inequality level country list. A higher employment rate between the mid-1990s and 2008, until the economic crisis, had also helped inequality not to skyrocket. OECD (2011) attributes about 70 percent of the total decrease in earnings inequality between 1990 and the mid-2000s to employment growth. However, between 2007 and 2010, market income inequality (before taxes and transfers) increased by 6 percent, surpassing the OECD average increase of 1.2 percent. **Figure 6** below displays the increase in Spain's net income inequality between 2003 and 2013. The sudden increase in the last years can be attributed to the changes in the labor market: Spain, along with the US, is one of the two developed economies where the inequality between the top decile earners and the bottom decile earners increased the most. The changes in wage distribution and job losses are responsible for the 90 percent of the inequality increase in Spain between 2006 and 2010, according to the International Labor Organization (2015). High unemployment figures and the large number of people who are on temporary contracts have an increasing impact on inequality in general (Ferrer-i-Carbonell et al. 2014).

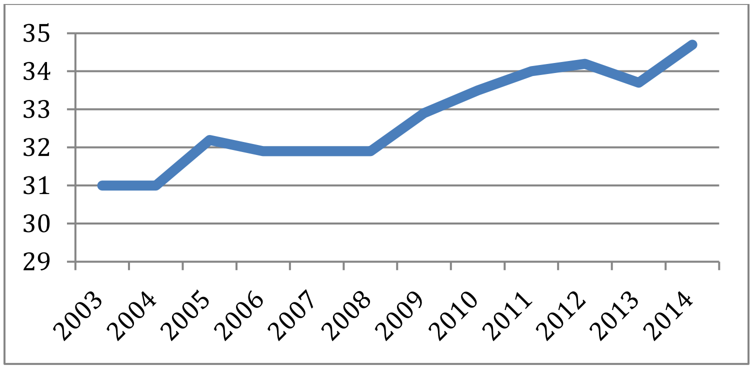


Figure 6. Spain's National Net Income Inequality, 2003 to 2013

Gini coefficient of disposable income, measured on a scale of 0 to 100

Source: Eurostat (2016)

5.4.2 Regional inequality in Spain: convergence or not?

In addition to national inequality, inequality measured at the regional level is also a key indicator for inequality, as the Spanish regions had distinct economies since the mid-nineteenth century, and before that, even independent economies (Martínez-Galarraga et al. 2015). Therefore, it is not possible to disregard the importance of the already existing regional variances that have helped sustain regional discrepancies and inequalities in Spain. Here, it is important to distinguish the different types of regional inequality measures. One is the inequality among the regions themselves in terms of production, where, e.g. regional GDP can be a proxy. Second, personal or household *Gini* inequality levels measured for each region, or income per worker or income per capita within the regions can be compared throughout the country to measure regional inequality. Therefore, regional inequality is measured at the personal or household, or at the regional level. In this section, I will refer to both of these types of measures of inequality.

As explained earlier with the example of "*Eight Spains*", the territorial governance structure contributes and sustains the regional discrepancies, despite the fact that, currently, national inequality is higher than regional inequality. According to the study of Martínez-Galarraga et al. (2015), in the 19th century, many regions in Spain had their own currencies, and transportation, investment and banking did not move freely across the regions. From 1860 to 1900, regional inequality grew, but after that point regional inequality in terms of income per capita decreased until the 1980s. Regional inequality in terms of income per worker also decreased until the 1990s, and after this point regional inequality in general was on the increase again in the period of 1990 - 2000. This is mostly explained with the Heckscher-Ohlin trade model, whereby between-sector differences in factor endowments led to asymmetric regional development (Martínez-Galarraga 2015). After the 1990s, partly due to the EU regional policies, labor productivity across the country diverged, which could pave the way for new regional income differences. As Martínez-Galarraga et al. (2015) explain, Catalonia, the Basque Country and Madrid appear as the richer regions, while Andalusia, Galicia, Extremadura and Castile-La Mancha are poorer regions.

The abovementioned study is also related to the argument of this dissertation, whereby decentralization comes with regional economic differentiation, where regions develop in different ways, paving the way for higher regional – and then national – inequalities. On a similar note, de la Fuente (2002) investigates the determinants of convergence across Spanish regions and attributes some of the decreases in regional inequality in the second half of the 20th century to educational and technological equalization, and redistribution of employment across regions.

Figure 7 below shows the regional *Gini* inequality levels of the Spanish ACs before and after taxes and transfers for 2010, using data from the OECD. The first two columns show the average Spanish inequality levels, followed by the *Gini* levels of the ACs, in ascending order according to *Gini* levels. Looking at the regional inequality data, the most unequal region, after taxes and transfers is the autonomous city on the north coast of Africa, Melilla, with 0.499 gross, and 0.385 (out of 1) *Gini* levels. Poorer regions exhibit higher *Gini* inequality levels; therefore there is a correlation between regional poverty and regional inequality in Spain.

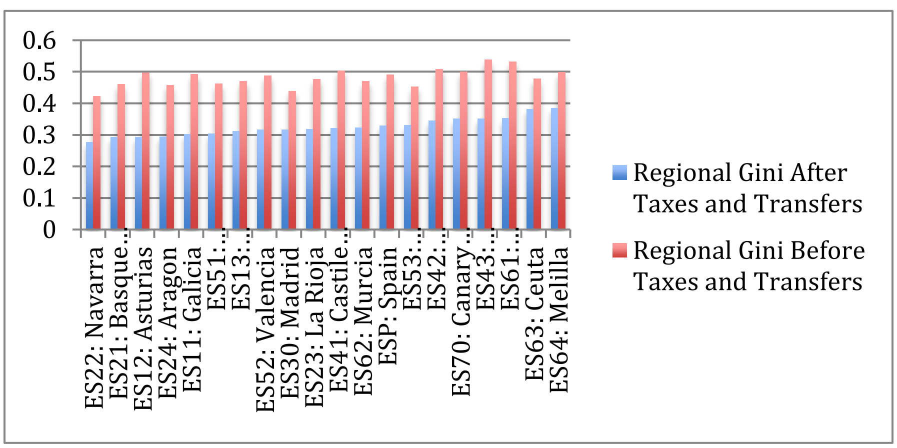


Figure 7. Regional Income Inequality Levels in Spain in 2010

Source: OECD (2016), Gini index measured on a scale of 0 to 1

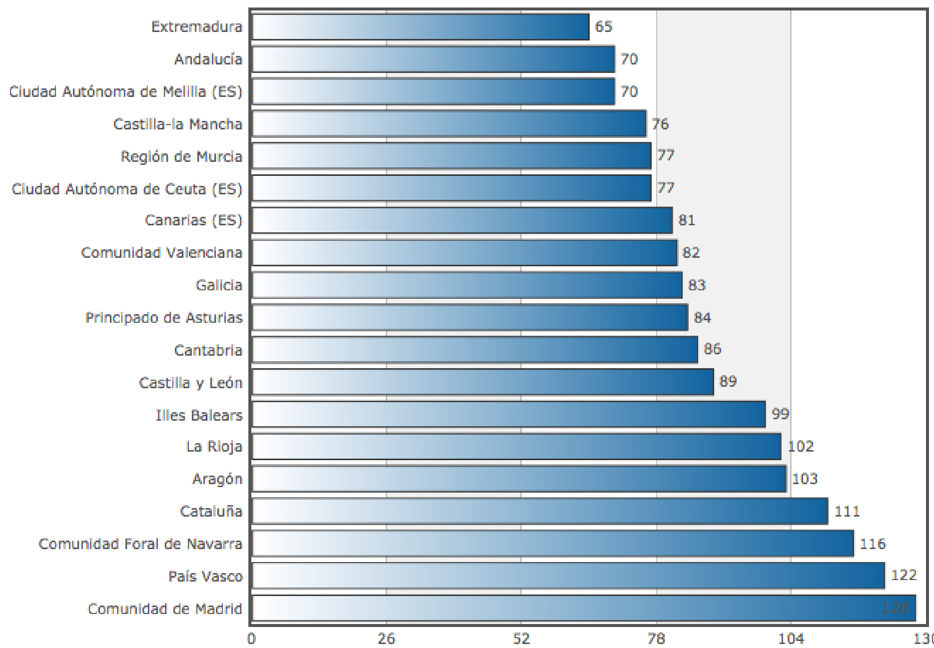


Figure 8. Regional Gross Domestic Product of Spanish Regions in Purchasing Power Standards in 2010

Source: Eurostat, European Commission

Current regional differences and inequalities can be demonstrated by looking at the GDP levels of each region, as well as regional *Gini* inequality levels. **Figure 8** above shows the regional Gross Domestic Product (GDP) of the Spanish NUTS-2 classified regions (ACs) in 2014 in purchasing power standards per inhabitant as a percentage of the EU-28 average, which can be taken as a measure of regional inequality. This figure shows that the regional GDP of the AC Madrid is 22 percent higher than the EU average, while AC Extremadura is only 65 percent of EU average, which is almost half of AC Madrid. The Basque Country (*Pais Vasco* as specified in the figure), Navarra, and Catalonia are also all above EU average with their regional

GDP. Spain is one of the countries - along with Greece, Southern Italy, and most of Portugal – where the GDP per capita of most of the regions fell below the EU-28 average due to the financial crisis (Eurostat, European Commission 2017).

In line with what the figures demonstrate, Beramendi (2012) states that the disparities in income inequality between regions (regional inequality measured in terms of Gini) is lower than the disparities in income per capita (national interpersonal income inequality) because there is more variation in regional GDP per capita (0.20), while for regional inequality, this variation (incidence of inequality) is much less (0.07) (using data from Uriel and Barberan 2007).[33] He also claims that there has been a decrease in terms of cross-regional differences in GDP per capita. This fact has also been expressed in the interviews: "*After 1982-83, we have seen a decrease in the gaps between regions, but we have to see what the situation has been after 2008 (the crisis). Still the gaps are not closed. At the end of the year, the Basque Country and Navarra give money to the central state; Catalonia wants a similar arrangement* (alluding to the fiscal asymmetries)".[34]

The efficiency of the financial arrangements is many times discussed with the 'equity' component of the arrangements with regard to the territorial structure. However, extant research suggests that this reduction has not been '*enough'* to compensate the differences in the regions. Ayala et al. (2010) have studied inequality and welfare in intra-territorial distribution by using data from different waves of the Spanish Household Budget Survey (*Encuesta de Presupuestos Familiares*) to examine the variations in the differences regarding inequality and welfare across different ACs in Spain, mainly because of the fact that the decentralization of the social welfare

[33] According to Pressman (2007), between 1980 and 2000, Spain witnessed a 3.2 percent reduction in the percentage of people belonging to middle class, which led to more polarization of incomes.

[34] Personal interview, Madrid, Spain, January 2013.

services requires a study with a spatial perspective by considering the minimum level of resources available. The authors analyze the differences in the inequality levels within each AC and their changes over time and the contribution to overall national inequality from these ACs. According to this study, there is a consistency of inequality among different regions. For example, La Rioja and the Basque Country had more ‘equitable distributive processes’ and this has changed after 1980s with the process of decentralization and industrial adjustments, contributing to regional inequality. Therefore, as the argument of the dissertation suggests, the regional differentiations have been associated with issues related to distributive policies. In the case of AC Madrid, the high level of inequalities has been sustained for a long time. Beramendi (2012) regards Madrid “*as the prominent rich and highly unequal region of Spain*”. Ayala et al. (2010) argue that the process of regional convergence, which started as of the 1960s and 1970s, reversed in the 1980s, and there has been a substantial increase in regional differences after the mid-1990s[35] even though regional inequality is still less than national inequality.

The conclusion of Ayala et al.’s study is that the ‘*internal differences in each autonomous region are virtually the only explanatory factors of inequality’*, which demonstrates that the territorial governance structure of Spain significantly matters for the national inequality levels as well. The poorer regions that benefit most from the fiscal flows such as Andalusia are more unequal than regions such as the Basque Country or Catalonia, which are net contributors to the autonomous community financing. Another outcome of the study is that higher growth and the overcoming of poverty in the poorer regions would necessitate an increased capacity for their own redistributive instruments, which would also lead to less inequality. However, by

[35] Ayala *et al.* (2009) state this with caution, indicating that previous research on regional convergence vary in terms of their results.

increasing transfer of responsibilities without increasing resources, the “convergence” of the regions is difficult. It is indeed the very reason that there is not enough capacity to assume redistributive policies in the regions, which, if existed, could have led to a more symmetric centralized redistribution.

At this point, it is important to take into account whether and to what extent the EU regional policies played a role in regional development in Spain. Spain has received the largest amount of EU regional policy funds in absolute terms, receiving approximately 200,000 Euros million between 1989 and 2020. For that reason, in the case of Spain, it is important to consider this variable. Especially between 1993 and 2003, Spain received about 25 percent of all of the Cohesion Policy funds (comprising of the European Regional Development Fund and European Social Fund). As of 2016, 8 percent of the total funds go to Spain, which is calculated as a 0.3 percent contribution to its overall GDP (European Commission, Regional Policy 2016). The Cohesion Policy has financed roads, motorways and train networks to connect the major Spanish cities with high-speed networks. Between 2007 and 2013, poorer regions in the south, such as Extremadura, Castilla-la Mancha, Andalucia, Region de Murcia, as well as Galicia and Asturias in the north had “convergence” objectives to improve the economic conditions of those regions, whereas the Regional Policy focused on regional competitiveness and employment in the more developed regions, such as Aragón, Baleares, Cantabria, Cataluña, Madrid, Navarra, País Vasco Canarias, Castilla y León, Comunidad Valenciana and La Rioja (European Commission 2009).

5.4.3 Summary: matching inequality with different periods of decentralization

Based on this information, how can we use this information on the Spanish case to test the argument? Thinking of the decentralization levels, is decentralization related to more national and regional inequality? Did different periods of decentralization actually correspond to higher or lower inequality? Here it is important to point out that inequality is a variable that does not substantially change very often. Therefore, it is difficult to attribute changes in (fiscal) decentralization to immediate changes in inequality and to state causality for one case with certainty. However, if we look at the different time periods of fiscal decentralization, the early period of fiscal decentralization, which follows the onset of democratization, also is a time where market national inequality (measured in terms of Gini index) increased. However, net income inequality does not seem to shift at that time. According to the Figure 2 shown above, inequality shows an increase until the mid-1980s, but in the early 1990s, both market and net income inequality show a decrease. According to Novo Arbona et al.'s (2016) classification, the time period of 1987 – 1991 was the period of harmonization of transfers and taxes among the regions, which corresponds to a decrease in the inequality. As Ferrer-i-Carbonell et al. (2014) also state, income equalization in this period is attributed to changes in the tax and benefits system. The period of 1991 – 2000 is classified in Novo Arbona et al. (2016) as the 'harmonizing' era where most of the political competencies of the regions were harmonized. As stated earlier, between 1997 and 2001, the ACs got more competencies in taxes, and in the following period, further financial equalization mechanisms were put in place. The latter half of 1990s sees a reduction in inequality, until the mid 2000s. Thus, one can argue that these financial equalization mechanisms are correlated with a decrease in inequality.

The time period of 2002 – 2008 is marked by equilibrium mechanisms among the regions again, while after 2009, the financial system has seen more centralization and some financial cuts, also related to the economic crisis. Since national inequality has been on the rise after 2008, at the least, we can argue that the reforms of 2009 have not helped Spain's inequality to at least remain the same, let alone decrease. Yet, one should also consider that this is occurring during a time of economic recession, and as Ferrer-i-Carbonell et al. (2014) argue, "clearly recessions exacerbate inequality" (p. 621). Similarly, when the economy was on the growth in Spain, it resulted in about 70 percent of decrease in earnings inequality, according to the OECD (2011). By looking at the decentralization of fiscal and social policies in more detail, I aim to refine the testing of the argument in the next section.

5.4.4 Fiscal policies: autonomous community financing and redistributive policies

"*Many studies have analyzed how the existence of a central state has conditioned the territorial deployment and innovation of the welfare state: should the capacity for territorial differentiation be sacrificed for the sake of guaranteeing equity in the state as a whole?"* (Gallego and Subirats 2011)

In this section, I first present how the autonomous community financing and the redistribution system works, and the criticisms of this system, because it is related to **fiscal decentralization** and the causal mechanism of the argument.[36] I elaborate on this topic also to set the backdrop of why fiscal asymmetry adds to the *non-interactive nature* of governance in

[36] There is a plethora of studies on fiscal flows in Spain, which mainly originated in Catalonia. This is also due to the fact that fiscal deficits in Catalonia have been associated with (regional) nationalistic claims as well (Espasa and Bosch 2010).

Spain, and how it contributes to more inequality. While Spain is decentralizing, the fiscal system is quite centralized in many respects, with low levels of shared fiscal control, as the *Regional Authority Index* data also indicate. Leon (2010) argues that "*the changeable and asymmetric nature of the process of decentralization*" is demonstrated through the distribution of intergovernmental transfers and unstable regional financing. Then, I look at the fiscal policies within the welfare state that have implications for the territorial governance structure and the decentralization process. Regional governments are argued to be stronger political actors due to the decentralization process, also because of the increase of their total share in public spending: In 1996, their share in total public spending was 23 percent but in 2009, during the latest financial reforms, this level was 36 percent (Simon-Cosano et al. 2013). From 1996 to 2002, there was evident fiscal decentralization with the institutional development of the state of autonomies. Responsibilities were transferred to the regional governments progressively. The central government's share of total public expenditures was reduced from 62.6 percent in 1996 to 51.5 percent in 2002 (Gunther et al. 2004, p. 365). Overall, one can say that more fiscal decentralization has occurred during the times of increases in Spanish inequality.

As an interviewed scholar of administrative law argues: "*Spain is decentralized in terms of expenses of its regions but centralized in terms of its revenues. In other words, the ACs can spend their own money and provide basic services like education, housing and health, however their revenues for these services largely depend on how much the central government provides to them, which is not always the desired amount*" [37].

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[37] Personal interview, Madrid, Spain, February 2013.

5.4.5 Taxes and financing for Autonomous Communities: fiscally federal or not?

Spain has two types of financing for its autonomous communities (ACs): The '*common*' system and the '*autonomous*' (also referred to as Foral or Charter) system that applies to the Basque Country and Navarra. Furthermore, there is a different economic and tax system for the Canary Islands "due to historical and geographical reasons" and in line with the European Union's policies for ultra-peripheral regions (Spanish Ministry of Finance and Public Administration). Additionally, the two cities of Ceuta and Melilla participate in autonomous financing according to their Statutes of Autonomy.[38] Beramendi (2012) argues that '*fiscal asymmetry refers to the constitutional facilitation and further political development of a two-fold system of fiscal federalism in Spain*" (p.182). At the regional level, the ACs can implement their budget, however, for the creation of the national budget, the ACs are not involved. As the government's (*La Moncloa*) website states:

"*At the national level, the drafting of the Central Government budget rests with the Central Government, and the scrutiny, amendment and adoption of the Budget lies within the purview of the Cortes Generales, the Spanish national parliament*." (Fiscal Policy, The Spanish Government).

Sections 156, 157 and 158 of the Spanish Constitution delineate how the financing of the ACs work. According to the articles in these sections, the State grants 'financial autonomy to the regions for development' but the main principles of "coordination" lie with the central state: [39]

[38] They also have a special indirect tax system, whereby they can collect Production, Services and Import Tax, instead of VAT.
[39] The concept of central state coordination will be analyzed in more detail later in the chapter, referring to vertical and horizontal types of coordination.

The Spanish Constitution

Section 156

1. The Self-governing Communities shall enjoy financial autonomy for the development and exercise of their powers, in conformity with the **principles of coordination** with the State Treasury and **solidarity among all Spaniards**.

2. The Self-governing Communities may act as **delegates or agents of the State** for the collection, management and assessment of the latter's tax resources, in conformity with the law and their Statutes.

Section 157

1. The resources of the Self-governing Communities shall consist of:

a) Taxes wholly or partially made over to them by the State; surcharges on State taxes and other shares in State revenue.

b) Their own taxes, rates and special levies.

c) Transfers from an **inter-territorial compensation fund** and other allocations to be charged to the State Budget.

d) Revenues accruing from their property and private law income.

e) Interest from loan operations.

2. The Self-governing Communities may under no circumstances introduce measures to raise taxes on property located outside their territory or likely to hinder the free movement of goods or services.

3. Exercise of the financial powers set out in Subsection 1 above, rules for settling the conflicts which may arise, and possible forms of financial cooperation between the Self-governing Communities and the State may be laid down by an organic act.

Section 158

1. An allocation may be made in the State Budget to the Self-governing Communities in proportion to the amount of State services and activities for which they have assumed responsibility and to guarantee a minimum level of basic public services throughout Spanish territory.

2. With the aim of redressing inter-territorial economic imbalances and implementing the principle of solidarity, a compensation fund shall be set up for investment expenditure, the resources of which shall be distributed by the *Cortes Generales* among the Self-governing Communities and provinces, as the case may be.

Encarnacion (2008) claims that the fact that central state in Spain collects nearly all taxes and distributes the revenues to the regions according to a formula that takes into account the size of the region, its per capita income and the number of provinces included in the region shows that this system is in stark contrast to an actual federal system. This type of tax collection and distribution stands in contrast to the norm in other federal systems, where spending by each state is financed by the taxes it collects from its own residents. Similarly, Colino and Kölling (2014) argue the following:

"*In Spain, characterized by the concurrence of many powers, the sharing of revenues, and a significant redistributive role of the central government, demographic, economic and political factors have led to a growing discussion on the discretion and fiscal autonomy of* *regional governments, and on the vertical and horizontal imbalances that lead to more or* ***less efficiency and equity*** *of the financial arrangements."*

While interviews with experts pointed out to similar points as the quote above, the central government argues that the 2009 reform of the financing system gives both autonomy and joint responsibility to the ACs, as the tax transfer percentages partially transferred to the ACs have been increased (The Spanish Government). According to the Ministry of Treasury and Public Administration, the 2009 reforms have the aim of ensuring both autonomy and joint responsibility of ACs and that the ACs can get more powers especially in the administration of taxes**.**

"*The principles of* ***autonomy*** *and* ***joint responsibility*** *are reinforced in this new system by way of the increase in tax transfer percentages partially transferred to Autonomous Communities and by way of the increase in the regulatory powers of these in terms of a greater capacity to decide on the composition and volume of income available. Likewise, mutual cooperation between Autonomous Community tax authorities and the State Agency is reinforced. There is also the new possibility of delegating to Autonomous Communities the administrative review of management activities directed by their tax authorities".*[40]

Catalonia is one of the richest ACs in Spain, which is constantly in the spotlight concerning intergovernmental relations in Spain. This is largely due to its secessionist claims, based on ethnic, political and financial matters, a view upheld in the latest 2015 Catalan parliamentary elections, and a referendum in 2014. While this dissertation does not focus on the

[40] More information about what constitutes tax can be found at this address. The Total Adequacy Fund operates as a system closure resource, ensuring that the overall financing needs of each Community in the base year are covered with its tax capacity, the transfer from the Guarantee Fund and the Adequacy Fund itself.

ethnic tensions between the central government and Catalonia, the issue of fiscal asymmetry, claimed to be to the detriment of Catalonia, has implications for Catalonia's secessionist claims (McRoberts 2001). However the two issues do not necessarily overlap all the time. An expert on fiscal federalism in Spain argued the following in an interview: "*Yes, I have certain opinions about why Catalonia should be independent [referring to ethnic considerations]. However, the issue of fiscal asymmetry and unfair treatment to Catalonia is an issue that is different and independent from the ethnic considerations. The central government should address the fiscal asymmetries no matter what [regardless of the ethnic tensions]*".[41] As Herrero-Alcalde et al. (2011) argue, some ACs that have strong nationalist tendencies also claim that they would better be served by a system similar to the Basque Country and Navarra's system due to fiscal imbalances.

The autonomous communities are financed through the "**Organic Law on the Financing of the Autonomous Communities**" (LOFCA), created in 1980 and reformed in 2009. As stated by the Ministry of the Treasury and Public Administration of Spain, the new financing system of the ACs came into effect after a "heated debate" between the central government and the ACs, the law has been passed at the *intergovernmental* **Fiscal and Financial Policy Council** in July 2009, reforming the Organic Law of 1980. This council works as a link between the central and the regional governments. The main aims of the system are stated as "*the reinforcement of welfare state benefits; the increase in the equality and adequacy in the joint financing of autonomic authorities; the increase in autonomy and joint responsibility; and the enhanced dynamics and stability of the system and its ability to meet the*

[41] Personal interview, Barcelona, Spain, February 2013.

needs of the public" (Spanish Ministry of Finance and Public Administration). In the beginning of the creation of the Common regime, the financing of the regions rested on lump-sum grants, which maintained the differences that existed across the regions without guaranteeing an equal public service provision and without giving any revenue autonomy to regions. The taxes that were ceded to regional governments can be regarded as components of the "tax-sharing system" until 1997, a time after which the ACs gained more revenue autonomy (López-Laborda et al. 2007). In the period of 1986 – 2001, the regional and ceded taxes were only 19 percent of regional revenues, and the transfers from the central government were about 76 percent, indicating that the regions did rely on the central government to a large extent (Leon 2010). Gordin (2004) argues that "*the centralist legacy transpires in the ongoing administrative and political hegemony" [in Madrid]"*. This point is also reflected in the typology of Colino (2008), where he argues that Spain is a "Type 4" federal structure with: "*High interdependence of levels, dependence of units on central funding and some softening of centrifugal relations*."

Since 1997, all ACs share personal income taxes – established on the tax base of the central government's personal income tax at a rate of 50 percent as of 2009 –, and there are also taxes that are shared between the central government and the ACs, which are VAT according to state consumption, and excise taxes on tobacco, alcohol and gasoline, shared at 57 percent. In addition, the ACs have "devolved taxes" (wealth tax, property transaction tax, inheritance tax, stamp duties, gambling tax, etc.) with the power to vary tax rates, tax credits and even some tax bases. They also have the power to raise surtaxes on devolved taxes and to create new taxes in tax fields not used by the central government. In addition to the ceded taxes, ACs can also introduce their own regional taxes (mainly environmental and gaming taxes), which are restricted by LOFCA especially to prevent overlaps with the central or local government taxes

(López-Laborda et al. 2007). Overall, the regional taxes are not regarded as taxes that would bring high revenue autonomy, as stated earlier in the chapter.

In addition to the Common System, the autonomous charter system covers the Basque Country and Navarra, and "recognizes the capacity" of these regions to carry out their own fiscal systems. Except for import duties and payroll taxes for social security, they have full autonomy over their "agreed taxes" and they have autonomy over all personal and corporate income taxes (López-Laborda et al. 2007, p. 301).

The equalization system has both vertical and horizontal instruments. As Beramendi (2012) points out, in general, that the financial capacity equalization is only limited to social services, health and education, and the others are not included in the expenditure needs of the regions. In addition to the devolved taxes, regions also get funds from the central government within the new financing model, which aims for 'horizontal equity' among the Autonomous Communities in Spain (Bosch and Solé-Ollé 2013). Within this system, there are several fiscal mechanisms to ensure that all the regions have adequate and sufficient funds in general. First of all, **the Total Adequacy Fund** aims to guarantee adequate financing of the different agencies of the ACs and cities with a 'Statute of Autonomy'. In order to guarantee the "minimum level of public services", according to article 158(1) of the Constitution and article 15 of the LOFCA, "*all Autonomous Communities shall receive the same resources per inhabitant, in terms of corrected population or unit of need, not just in the first year of application, but also in the future. This also helps to increase equality in the system of Convergence Funds (to be mentioned subsequently), created through additional State funds for the purposes of reinforcing the convergence in financing per capita and convergence in the levels of the public's quality of life*." The **Total Adequacy Fund** is determined taking into account changes in the amount of shared taxes of each AC, and the main aim is to make sure the ACs cover their financing needs with their tax capacities.

Moreover, the *horizontal* **Essential Public Services Guarantee Fund** has been established to make sure that the ACs receive the same resources per inhabitant in terms of corrected population or unit of need. It aims for the ACs to receive similar amounts of essential welfare state services (which are education social services, education or health) (Bosch 2011). This fund is allocated using 75 percent of the AC regulatory tax revenue, plus funding from the central government. 75 percent refers to the 'weight of welfare state spending in relation to regional spending'. Also it is important to note that the resources of this fund are distributed according to their adjusted population, unit of need and their needs for spending due to other variables not related to their population, such as their spread, surface and insularity. The fund is calculated using their expenditure needs and their normative tax revenue or fiscal capacity. The main aim is to bridge horizontal disparities by redistributing resources from regions that have above-average fiscal capacity to those that are below average (Martinez-Vazquez and Timofeev 2015). The **Global Sufficiency Fund** is aimed at closing the remaining "regional vertical gaps" which is determined by looking at the following: The difference between what the ACs need for their expenditures and their overall regional fiscal capacities and the Essential Public Services Fund. These two funds are considered as *general-purpose grants* (Ibid 2015).

Bosch (2009) argues that the main problem with the financing system before 2009 was that there was no explicit criterion for fiscal equalization, pointing out to the **centrifugality** of the system. In fact many of the studies on fiscal flows in Spain originated in Catalonia due to the sensitivity of this issue for the region (Espasa and Bosch 2010). Catalonia prefers both to renegotiate the fiscal transfers model to make it more similar to the Charter system of Navarra and the Basque Country, which is also in line with the autonomy demands (Leon 2010). As one expert explained in the interview: *"If some regions produce more than the others (such as Catalonia), this creates resentment, also showcased by more autonomous tendencies"*.[42] According to a study by Bosch (2011), with the new 2009 financing model, Catalonia ended up being the region with the highest increase in resources in *absolute* terms with 1,986 million Euros, followed by Madrid (1,641 million) and the Valencian Community (1,413 million) and Andalusia (1,088 million) in the year 2009. However, when we think of the resources in terms of per capita, Balearic Islands ends up the first with 486 Euros, and then the Valencian Community (283 Euros), Madrid (273 Euros) and Catalonia (269 Euros). The regions that supply the most revenues to the central administration are Madrid, Catalonia, Andalusia and Valencia. Bosch (2011) also concludes that 75 of percent what the regions raise as tax revenues is equalized as a result of the Essential Public Services Fund, but the remaining 25 percent is not equalized.[43]

As far as revenues per head contributed to the system, for example, Madrid contributed 7977 Euros and Extremadura contributed 3766 Euros (Espasa and Bosch 2010). The new system has not solved the problem, Bosch argues, although there is a higher convergence of all Communities towards the center in terms of revenues per person, with less standard deviation among different regions. Bosch (2011) explains the general tendencies of the fiscal flows by pointing out to the asymmetries in resources per capita: "*The territorial distribution gave arbitrary results as well as over-equalization, in the sense that, after equalization, those*

[42] Personal interview, Madrid, Spain, January 2013.
[43] If the revenues of the regions were not equalized, Madrid would end up with 145,9 Euros per capita.

Communities with greater fiscal capacity ended up with fewer resources per capita than those with lower fiscal capacity".

If we look at how much the fiscal flows bridged the regional gaps of income, Espasa and Bosch (2010) report that in 1991 – 96, fiscal flows originating from the central government reduced the inter-regional differences by 33 percent in terms of income per person, and that it is actually slightly lower than the level of France (38 percent reduction) and a little higher than the UK (26 percent reduction), which are two unitary countries in Western Europe. In general, it is argued that this system is biased towards transfers and the ACs prefer to increase their revenues through flows rather than increasing their own taxes which would make them bear the political costs (Leon 2010); hence there is less movement towards increasing fiscal autonomy or fiscal control. Lago (2010) points out to the budget constraint that arises from this issue, which is that while regional tax autonomy has increased, the regional leaders do not prefer to use it, and they instead opt for more indebtedness or increasing grants from the central government.

In addition to the abovementioned ones, there are two main Autonomic **Convergence Funds** for fiscal equalization: **The Competitiveness Fund** and the **Cooperation Fund**. **The Competitiveness Fund** is utilized to bridge the gaps in standardized financing per capita between the ACs. Another official aim is "*encouraging fiscal capacity and autonomy and discouraging downward tax competition*". The regions that have a below average per capita financing or fiscal capacity are eligible to get this Fund. The main goal of this horizontal

Cooperation Fund is to create a more equitable balance of regional development by fostering growth, development and convergence of regions. [44]

As the Article 158 of the Spanish Constitution stipulates**,** the **Inter-territorial Compensation Fund (ICF)** is another official equalization mechanism to counteract the gaps between regions to implement the ‘solidarity’ principle, in effect in its current form since 2001, which is a system of **intergovernmental grants** providing funding for education, health and transport.[45] It was actually founded in 1978 to reduce economic disparities, and in the beginning of its formation, ICF was also used for financing investments of services that became competencies of regional government as a result of decentralization (Mancha-Navarro and Yserte 2010). These funds are now distributed among the ACs that have a lower income and the autonomous cities of Ceuta and Melilla.

The relevant articles in the Constitution demonstrate that the issues of inter-territorial economic imbalances and the importance of maintaining ‘solidarity’ among the regions are addressed. However, it is necessary to assess whether these aims are realized by the actual practices of fiscal flows. Do these funds and the autonomous financing system reach its aims? The study by Herrero-Alcalde et.al (2010) shows that Spain’s **Interterritorial Compensation Fund** distributes more resources to the regions with lowest economic activity, but not all the

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[44] The setup of these two Convergence Funds rests on the following: “It is shared out on a yearly basis between common regime Autonomous Communities with a GDP per capita of less than 90% of the average, with a population density of less than 50% of the average density or that, having population growth of less than 90% the average, have a population density per square kilometers lower than the resulting figure from multiplying by 1.25 the average density of common regime Autonomous Communities.” (Spanish Ministry of Finance and Public Administration)

[45] The amount cannot be less than 35% of the investment from the State and its Autonomous Bodies, weighted by the population and relative income of the beneficiary Autonomous Communities and Cities.

regions that would need this fund are eligible.[46] Before the 2009 reforms, the territorial distribution system was regarded as arbitrary and also overequalizing, which meant that ACs that had larger fiscal capacity had fewer resources at the end of the year (Bosch 2011). After 2009, the Competitiveness and the Cooperation Funds have aimed to bridge the gaps in per capita resources among regions, in order to help poorer regions and/or those that suffered from the 'overequalization' (Ibid 2011).

In general, intergovernmental grants are necessary when the government budgets at different levels are not balanced through other fiscal equalization transfers after the regional tax autonomies are determined and can be regarded as "residuum" (Smart 2006). After the 1978 decentralization reform, the central government established a system of grants to provide funding for education, health, and transport. Currently, capital grants in Spain amount to about 30 percent of the local government investments. The system of grants/transfers was reformed in 1991, 1997, 2001 and 2009. Herrero-Alcalde et al. (2010) argue that during all of these reforms, the fact that regions have different investment and infrastructure needs and that they might have varying territorial distributions was not taken into account.

In total, the national government accounts for about 57 percent of **recurrent grants** to sub-regional governments but only for 12 percent of **capital grants** (Martinez-Vazquez and Timofeev 2015). By contrast, regional governments account for 26 percent of recurrent grants to sub-regional governments but for 52 percent of capital grants. Most of the recurrent grants from the central government are not earmarked but those from the regional governments are. For example, the Interterritorial Compensation Fund, or the Structural Funds from the European

[46] Only ACs with per capita income under 75 percent of the EU are eligible for the grant (Herrero-Alcalde et al. 2010).

Union are used to finance regional capital expenditures. The figure below shows the percentage of the overall earmarked and non-earmarked intergovernmental state grants in Spain between 2000 and 2010, with earmarked grants decreasing dramatically as of 2001 and then continuing at a slightly increasing rate but stabilizing around 20 percent. This means that the total non-earmarked grants have increased almost 30 percent in this period, indicating more autonomy. Data also indicate that matching grants are quite low in the case of Spain. Figure 9 below shows the earmarked and non-earmarked grants by type-percentage of total grants revenue in Spain. The fact that the total number of earmarked grants has grown and then stayed about the same indicates decentralization and more discretion to regions in the early 2000s. Martinez-Vazquez and Timofeev (2015) find that the road density in Spain over time is significantly correlated to more capital grants, but in general it is difficult to argue that grants totally close the regional disparities. Looking at investment and capital stock at the province level between 1978 and 2004, Sole Olle (2010) shows that the regional allocation of public investment in Spain is determined by constitutional rules, which are mainly based on regional income and need. During the dictatorship, equity was not the aim, but after democratization it slowly became the norm, especially after the start of the flow of the EU Structural Funds into Spain. However, he shows that ideology is an important determinant, with left-wing governments redistributing more than the right-wing governments. Simon-Cosano et al. (2013) find that the main driver of intergovernmental grant allocation is the debt the regional units have, rather than a strategic use of these grants.

Among different types of central government funding, especially regional investment on infrastructure, such as railways or motorways, can have a centralizing tendencies. Bel (2011) shows that when considering investment / GDP regional ratio and the distance to Madrid, the six regions closer to Madrid have much higher investment ratios than other ones in Spain, such as Castille la Mancha and Castille-Leon, surrounding Madrid. The political tendencies in investment allocation is a caveat to keep in mind, since most of the central government investment aims to connect the regions to Madrid, which Bel (2011) calls the centralization policy. Therefore, the centralized or decentralizing tendencies can also create policies that will in return contribute to the existing decentralization levels.

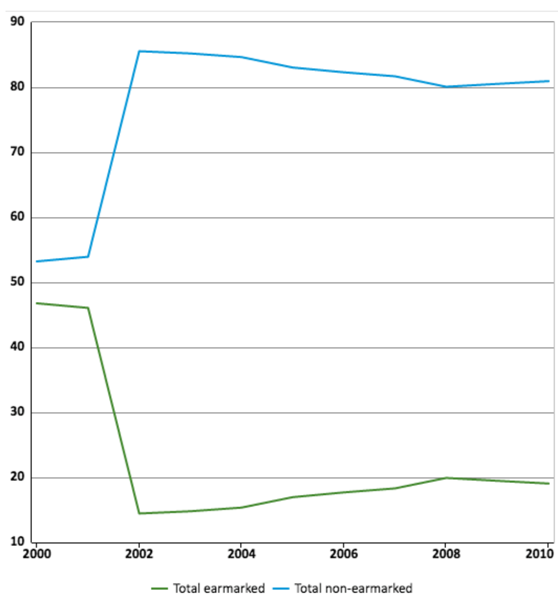

Figure 9. Earmarked and Non-earmarked Grants by Type-Percentage of Total Grants Revenue in Spain

Source: Knoema Data Atlas, OECD

5.4.6 Social policies: health policies and minimum income schemes in Spain

"*If decentralization has tended to be interpreted as a process that can help improve the quality and the responsiveness of the welfare policies, for some it can endanger equity because of the dynamics of differentiation and the generation of new inequalities that it entails*" (Gallego and Subirats 2011, p.99).

As Gallego and Subirats (2011) state with the abovementioned quote, the impact of the ACs in welfare state implementation, evidenced by their control of around a third of social spending and management of health workers and teachers with their own institutions, make the process of Spanish decentralization and the role of the autonomous communities a crucial point to study in the debate of inequalities. The authors argue that the initial conditions of the ACs, different timelines of their gaining of autonomies, and differing regional government budgets lead to discrepancies in their welfare state capacities and implementation. The absence or at least the weakness of shared and horizontal coordination mechanisms for the welfare state has facilitated the bilateral rather than the multilateral nature of the following welfare state policies in Spain, (Gallego and Subirats 2011). Also, this bilateral nature of fiscal intergovernmental relations increased the bargaining power of the regions in this process (Leon 2010), perhaps with a more piecemeal nature rather than a multilateral nature.

Especially social services, health and education policies have become largely decentralized in Spain starting with the 1980s. Currently, within welfare state policies, only **unemployment policies and public pensions** are centralized (Rodriguez Cabrero 2011). When the Spanish welfare state was consolidated in the period of 1986 – 1995, it was also a time of general strikes. The "new welfare state" was also shaped by compulsory education, as well as the **minimum income schemes policy,** and the **universalization of health system and pensions** happened during this time, which also saw a reduction of inequality and extreme poverty rates (Rodriguez Cabrero 2011). By looking at the health and minimum income policy, I aim to shed more light on this issue. The devolution of services to ACs has led to some regional divergence in Spain, which had long been a fragmented and unequal structure.

5.4.6.1 Health policy in Spain and inequality

Health policy in Spain has been transformed during the decentralization process, first with the 1978 Constitution and then with the General Health Law of 1986, applying to all the ACs (Rodriguez Cabrero 2011). As of the 1990s, the ACs gradually have started to gain more competences in health care policy. Spain has a universal healthcare system, which is mainly administered by the ACs. Health care financing rests on general taxation and is a part of the general financing system of the ACs, but in terms of implementation, it is very decentralized and health care service has modernized to a large extent within this decentralization process. The proportion of people over 65 years of age and the degree of isolation are the main factors when determining the health care budgets of ACs (Rodriguez Cabrero 2011). Overall health spending has not grown in the recent decades. While in 1992, 77 percent of the total health spending was public health expenditure, this number decreased to 72 percent by the end of 2000s; therefore sustainability of health care policy is a concern (Navarro 2009).

The Ministry of Health, Social Policy and Equality is the main ministry at the central level to design health care policy in Spain. As a result of the 1986 General Health Act, there are 17 Regional Health Services of the ACs. The seven historic regions obtained their health competences between 1981 and 1994, and the others got them during the second phase in 2002.

The reason why health care policy is important to analyze concerning the territorial governance structure is that more than a third of the total budget of the regions is used for health care. The ACs have complained about being responsible for pharmaceutical expenditures, representing more than 20 percent of the expenditure, but not having a say in the relevant decisions, which can be regarded as evidence for more non-interactive governance (Maino et al. 2007). With the Cohesion and Quality Law of 2003, more cooperation between different levels of government became a central aim. The Spanish Fiscal and Financial Policy Council decided on more fiscal decentralization with more health care funds that would be incorporated into the block grants, which has been implemented since the early 2000s. As Maino et al. (2007) state: "*the process of negotiation and cooperation between the ACs and the central government are, from now on, a key element in order to avoid fragmentation, and as a consequence, undesirable inequalities*" (p. 130-131). A new Commission was created in order to prevent conflicts between different levels of government, which had emerged in 2003 between different parties at different levels. The most important elements of the health care policy in Spain has been the correcting the territorial and social gaps in public health care and the ACs slowly started incorporating these elements to their health systems. As Gallego and Subirats (2011) explain, the creation of certain health standards and regulations in Catalonia in the 1980s were actually adopted by other regional governments or the central government, so the diffusion went from regional to the central level. While there is still differentiation among different regions concerning health care provisions, the universal health care principle exists throughout Spain.

One of the frequently mentioned features of the health care system in the elite interviews was that AC Madrid decided to deliver the healthcare services by public-private partnerships, unlike other regions. For example, after Esperanza Aguirre became the President of Madrid in

2003, the health services went through a change where the regional government provided the service while the management rested with the private sector, causing ambiguities on who was responsible of the hospitals. The Madrid hospitals are now run with public finance initiatives and public private partnerships, causing debates of efficiency versus reducing costs for the government/increasing costs for the citizens.[47] Regions of Castile-La Mancha, Extremadura, La Rioja and Navarra have public and direct health provision models, while Catalonia, Valencia, the Balearics and Madrid have indirect health care provisions through private suppliers.

Testing an argument similar to this dissertation, in order to understand the importance of the territorial governance structure on health inequalities, Garcia-Gomez and Lopez Nicolas (2007) find that there are geographical disparities in health in Spain, based on the respondents' assessments in the Spanish National Health Survey. For example, regions with the highest levels of mean health also have the lowest degrees of "income related health inequality" and vice-versa. More specifically, Basque Country, Navarra and La Rioja are the regions with the highest levels of mean health and they are also the regions that have the least income related health inequality, indicating a correlation between income and health inequalities. On the other hand, the region of Murcia has the least levels of mean health, as well as the largest income related health inequality. Regions that are richer such as Madrid, the Balearic Islands and Catalonia also have high health inequalities. The main finding of this work is that if there are policies that are devised at reducing the correlation between health and income, this might lead to reductions of inequalities in health, more so than redistributive policies. However, it is not easy to attribute a direct causal relation between service decentralization to service inequality, such as in the area

[47] Aguirre was the President of Madrid from 2003 until 2012, from the right-wing Partido Popular (El Pais 2012).

of health care (Ferrer-i-Carbonell et al. 2014, Lopez Casanovas 2005). Another study by Regidor et al. (2002) looking at self-reported health also finds that health inequalities in Spain are correlated to social class and education. As Maino et al. (2007) state this decentralization process also had an impact on the salaries of the health care professionals. For example in 2002, the regional governments that received health transfers at the beginning of the year for the first time, also signed agreements with the trade unions to equalize salaries with those of the other regional health services (p. 132).

5.4.6.2 Minimum income policies in Spain and inequality

Minimum income policy and its relevant schemes are another important social policy that is impacted by the territorial governance structure of Spain. Minimum income in Spain varies according to the position of the recipient in the labor market. The ACs have minimum income schemes since 1989, but the central government also intervenes in this policy with contributions to social security and social assistance programs, some of which are directly managed such as contributory pensions or unemployment benefits. As the last resort, non-contributory regional pension schemes exist alongside the central government's minimum income schemes (Rodriguez Cabrero 2009, 2011). Ferrera (2005) claims that there is no real coherent and coordinated minimum income scheme that which is "Europeanized" according to the EU's national social protection schemes. Rodriguez Cabrero (2011) argues that According to the Living Conditions Survey of 2008, the minimum incomes replicate the hierarchy of poverty that is dependent on the individual's position in the labor market, and that the dual system leads to certain coordination problems. Minimum income policy is one of the welfare state policies where the state aims to balance the central coordination needs and the regional interests of the

ACs. As Rodriguez Cabrero (2009) points out, the effect of minimum income schemes in reducing poverty and inequality should be considered with respect to regional disparities. The social assistance unemployment benefits or minimum incomes have low or differing coverage protective intensity and temporary contracts also reduce the positive impact of minimum income schemes in reducing poverty, and subsequently inequality.

5.4.7 Summing up: decentralization of the welfare state and inequality in Spain

To test the argument of the dissertation: Does more decentralization also correspond to higher inequality, when the welfare state policies are considered, in addition to the fiscal decentralization? Spain decentralized in the 1980s politically and fiscally – and the aftermath of this decentralization has seen a decrease in its inequality. The direct causal impact of social service decentralization on inequality is difficult to demonstrate, but two general findings emerge: 1) Regional economic disparities do translate to health inequalities, but this builds on previous economic variations, 2) Variations that emerge through decentralization of minimum income policies could result in differentiations in the amount in the future, contributing to higher national inequality. As Ferrer-i-Carbonell et al. (2014) argue, the regional public services devolution did not led to further regional divergence which would build on existing regional economic, political or social variances, as expected.

In short, in the case of Spain, political decentralization does not always coincide with higher inequalities; there is fiscal decentralization, and the asymmetries that have emerged out of the fiscal equalization system are related to variations in income per person in the regions. The fiscal equalization and the taxing system is still quite centralized, but as the interviews suggest, the balance between the centralized and the decentralized fiscal system is not executed in a way to decrease the overall high national inequality in Spain. To repeat, OECD (2015) argues that public services in Spain do decrease national inequality about one fifth. The increases in national inequality were not matched by regional inequalities, so in this respect, Spain's fiscal equalization system has not totally been ineffective in the reduction of inequalities.

Gallego and Subirats (2011) argue that democratization has led to the reduction of territorial based welfare state inequalities and that the regions can make decisions, but still, the more developed regions can provide better welfare for their citizens, sustaining the already existing inequalities. Overall, the period of the consolidation of the welfare state (1986 – 1995) saw reductions in inequality and poverty in Spain, whereas the period which is referred to as Europeanization saw some increases in inequalities, which also saw the universalization of protection. Political, administrative or fiscal decentralization is associated with higher inequalities, but as the theory suggests, more interactive governance can offset the inequality inducing effects of decentralization. Thus, it can be argued that decentralization might not explain the whole story, and that the nature of interactions of the different governmental levels and social actors also explain the formation or the sustaining of economic inequalities.

In the next part, I look at the interactions in Spanish governance to test its interactive governance level. The aim is to uncover the part of the link between the territorial governance structure and inequality, which still remains unexplained by the case study so far.

5.5 INTERACTIVE GOVERNANCE IN SPAIN: INTERGOVERNMENTAL RELATIONS AND THE ROLES OF SOCIAL ACTORS

I classify Spain as a low interactive governance country, but what really makes it less interactive than another federal country in the typology of this work, Germany? And why does this matter for inequality? While the tax and redistributive practices and the welfare state policies in Spain illuminate the link between the territorial governance/decentralization and inequalities, the argument of this dissertation goes beyond this link. As stated earlier, I argue that while decentralization is associated with higher inequalities, shared rule of the regions and more interactive governance would help offset the inequality increasing structure in a country, due to the coming together of various state and non-state actors towards similar goals at different territorial levels. In the statistical chapter, I measure interactive governance by looking at the variable of fiscal control. This section aims to apply to the theory on the Spanish case by expanding on this variable with qualitative evidence. The main keywords from my interviews, which were used to describe the Spanish governance structure, contributing to more non-interactive governance are:

- Asymmetric
- Non-congruent
- Centrifugal
- Unequal
- Fiscally unfair– as considered by some regions
- Lack of leadership (at the national level)

As in the other case studies, I first look at the **intergovernmental** aspect of interactive governance and then assess the **role of social actors** in policies that matter for inequality. Within this discussion, I highlight the importance of *vertical* and *horizontal* coordination practices between different governmental levels and relevant non-state actors (or lack thereof) in the policy making process. I examine whether there are channels through which the central government interacts with the subnational units and the non-state actors in the *formulation* and the *implementation* of the main (social and fiscal) policies / issues that matter for inequality. How centralized or decentralized is wage coordination and what is the role of non-state actors? Within this debate, I will discuss the difference of the governance structure in Spain from a corporatist/ neo-corporatist structure. I display the summary of this section with the "Interactive Governance Index" which is my own elaboration from the data provided in this section.

5.5.1 Decentralization, intergovernmental relations and interactive governance in Spain

In the theory chapter, I established the link between the shared-rule dimension of federalism with more interactive governance. Referring to the self-rule and the shared-rule dichotomy of Elazar (1987), Beramendi (2012) highlights the lack of systematic coordination in Spain resulting from the decentralization process, which is related to a non-interactive type of governance:

"*At this point we may safely argue that after twenty years of permanent decentralization, Spain qualifies as "federal" in all respects related to the first dimension. But it can also be argued that, in terms of* ***shared rule****, Spain does not qualify as federalist at all. Shared rule implies* ***a systematic, coordinated and institutionalized*** *means for making all those decisions affecting both realms of power in such a way that both nationwide and regionally bounded interests are represented and protected*" (p. 181).

If the interactions are not systematic or coordinated to qualify for strong "share-rule", how do the interactions take place in the case of Spain? As stated earlier, the Spanish territorial governance system is known to be in constitutional "flux" and flexibility with different subnational units gaining more powers at different points. As one interviewed expert puts it, "*Spain evolved to a federal form* ***without the needed coordination mechanism*** *for federal systems. There are a lot of vertical relationships but no horizontal relationships. For standardization between the regions, coordination of the central government is necessary. But it doesn't exist, and the gap between the regions is difficult to avoid. There should be coordination instruments, there should be territorial cohesion, but there isn't.*"[48] Börzel (2002) argues that the ACs actually rejected multilateral intergovernmental cooperation platforms "that would coordinate the exercise of shared competences" (p.101), again highlighting the bilateral nature of the relationships of the central government with the regions. Perhaps, it is difficult to argue that either the central government or the ACs are directly responsible for the less interactive nature of governance in Spain, as they have capitalized on the existing asymmetric territorial legacies.

The reliance of the regions on the central government for coordination remains high (Agranoff 2004) and this does not fit with the features of neither a unitary and highly coordinated central state nor a coordinated federal state. It is important to note that the horizontal cooperation agreements between the regions have to be approved by the lower house according to the 145.2 of the Spanish Constitution (Leon 2011). Therefore, the vertical relationship takes precedence over the horizontal relations. The main intergovernmental

[48] Personal interview, Madrid, Spain, January 2013.

cooperation platforms are the bilateral commissions (*juntas de cooperacion*) and intergovernmental agreements (*convenios)*, the latter having played an important role in the decentralization process with a legal basis.

The level of interactions in governance can also be understood through the way the ACs (subnational units) can influence the amendment processes of the Constitution (national level). The national unity and the regions' demands for subnational autonomy are two tendencies that consistently need to be balanced and coordinated by the central government in Spain. The main subnational units – ACs – are regulated by their "*statutes of autonomy*", and not specifically through the Constitution, since the territorial governance structure necessitated more flexibility for power sharing (Colino 2009). Also, Börzel (2002) argues that Spanish territorial politics are more "judicialized" than e.g. Germany, where conflicts are resolved more by intergovernmental means, since the ACs in Spain prefer resolving conflicts through the Constitutional Court. The process of the revision of the statute of autonomy of Catalonia in 2000s had implications for national cohesion, as Colino (2009) argues:

"*For the first time, the central government has been in a* ***reactive*** *position, trying to control the scope and impact of the reforms. This has tested the capacity of the system to adapt itself and maintain its basic stability and legitimacy, forcing it to respond to the new demands of regions and the requirements of national unity, cohesion, and survival.*" (Colino 2009, p. 264)

Furthermore, the extent of Catalonia and other ACs' autonomy depend on the willingness of the center (McRoberts 2001). Requejo (2005) points out to the fact that for a long time the ACs did not have direct participation at the EU level, unlike other federations like Belgium or Germany and this also underlines Spain's similarities with actual federal countries (European Union Committee of Regions). The ad hoc nature of the intergovernmental negotiations detract from the stability of intergovernmental relations concerning this issue, as Gordin (2009) states:

"*Negotiations are based on bilateral bargaining that clearly dilutes the formation of subnational coalitions and, second, intergovernmental negotiation occurs mostly through ad hoc meetings between the executive levels of the governing parties, to the detriment of any meaningful parliamentary process of scrutiny*".

Concerning its fiscal intergovernmental relations, Spain's fiscal decentralization level has been classified as 'collaborative decentralization' by Gordin (2009) as a "*game being played between the central government and the regions but also as an issue subject to inter-state conflict*". Gordin argues that this is the opposite of 'cooperative decentralization' in Germany, because during the fiscal transfers, central governments tend to reward regions that are richer in revenues and that are more assertive to develop their own autonomy in Spain. This result is attributed to the centrifugal tendencies that have prevailed since the beginning of the democratization and the decentralization process. However, studies by Bosch (2011) and Herrero-Alcalde et al. (2011) refute this point, as the results of the fiscal equalization grants are found not to reward richer regions like Catalonia.

"The Guarantee of the Unity of Markets Law", passed in December 2013 (*la ley de garantía de la unidad de Mercado*) is another attempt of the central government at creating unity throughout different regions of Spain, whose possible equalizing effects are yet to be evaluated. It is inspired from the EU regulations on the internal market and the main aims of this law are non-discrimination by place of residence or establishment for economic activity, national unique validation principle for goods produced in all the regions, better regulation principles and administrative cooperation (Spanish Ministry of Economy and Competitiveness). As León Sanz

(2013) argues, this law aims to apply the principles of freedoms and equality enshrined in the Constitution over the differences that might emerge from regional autonomies:

"The Act is not intended to harmonize the laws because, as the Constitutional Court has already stated on many occasions, unity does not mean ***uniformity****, because the same territorial configuration of the Spanish State and the existence of entities with political autonomy, such as autonomous regions, is a variety of legal regimes*."[49]

5.5.2 Vertical and horizontal coordination channels in intergovernmental relations: Sectoral Conferences

Due its very centralized and hierarchical basis during the Franco period, the government did not have an important coordinating role for the spending policies and most tasks fell on the ministries of finance and planning who had high decision making authority (Gunther et al. 2004). Actually, there were technocrats who were in favor of regional policy during the Franco time, but fears about Basque and Catalan nationalism prevented the institutionalization of such policies (Keating 1997). Nevertheless, as a result of the decentralization, the central government had to establish platforms and channels for intergovernmental relations, such as the Presidents' Conference (*Conferencia de Presidentes*) created in 2004, where the regional ministers and the prime minister convene, and the Conference on Regional Governments.

[49] Officially titled 12888 Ley 20/2013, de 9 de diciembre, "De garantía de la unidad de Mercado"

Perhaps, the key intergovernmental platform that matters for issues related to inequality is the 'Sectoral Conferences' (*Conferencias sectoriales*) (or sometimes referred to as Sectoral councils or committees), which allows for institutionalized intergovernmental relations on the issues of local affairs, infrastructure, territorial organization, social services, urban affairs and fiscal and financial affairs. The first Sectoral Conference was created in 1981, but it was in 1992 when they first started functioning more regularly. According to the Spanish Ministry of Public Administration, currently 35 Conferences exist but only 25 have engaged in regular activity in recent years, and that "their pace of work and the nature and importance of the subjects they address are not equal" (State Secretary for Territorial Cooperation). Even when they were first founded, they were viewed as an "imposed" intergovernmental cooperation by the central government and they also led to further intergovernmental conflicts rather than cooperation, as Börzel (2002, p. 97) argues.

The Council of Fiscal and Financial Policies of the Autonomous Communities (*Consejo de Política Fiscal y Financiera de las Comunidades Autónomas*) was one of the first Sectoral Sonferences to be created in 1980 by the LOFCA (Organic Law on Financing of the Autonomous Communities) with a view to coordinating the financial activities of the ACs with that of the State Treasury. Therefore, it is a platform for both vertical as well as horizontal coordination. The Minister of Finance and Public Administration and the Minister of Finance of each AC attend the Sectoral Conference meetings. For example, in 2009, this Conference met to discuss the reforms for AC financing, for more autonomy to be granted to the ACs. Some of the outcomes of the meetings were a guarantee of equal funding of basic public services for all citizens, regardless of the autonomous community where they reside to contribute to more regional balance and the creation of two Convergence Funds with additional funding provided by the State with the aim of reducing differences in funding between the ACs and achieve greater equality.[50] Also, competitiveness and cooperation funds were decided to ensure territorial cohesion of the welfare state and to reduce the financial deficits among the autonomous communities.

With a view to understanding their impact on the welfare matters, I looked at the frequency of the meeting of the *Council of Economic and Fiscal Policies* in the periods of 1981-1992, 1992-2009, 2010-2016 and the total number in all these periods. It is the 5th most frequently meeting Sectoral Conference, having met 5 times in the 1981-1992 period, 47 times in the 1992 – 2009 period and 22 times in the 2010-2016 period, with a total of 94 meets. Obviously, some other conferences other than this specific one are related to the welfare state policies discussed as well, as the financing of the ACs is not the only variable that I study in terms of its impact on inequality. Until recently there had not been much empirical research on the effectiveness of the Sectoral Conferences but most research focuses on the differences among the different conferences (Börzel 2002, González Gómez 2005). Leon and Ferrin Pereira's (2011) research on Sectoral Conferences has explored the conditions that impact multilateral cooperation. The evidence shows that there is more intergovernmental cooperation when the issue at stake concerns financing of the subnational units, so in that respect these conferences has recently become an important intergovernmental institution, implying an attempted increase in both vertical and horizontal coordination. Also they find that the incentives for cooperation are better when the federal government and subnational units have some decision-making authority over a policy area. They enable the cooperation between the

[50] The official law: Acuerdo 6/2009, de 15 de julio, para la reforma del sistema de financiación de las Comunidades Autónomas de régimen común y Ciudades con Estatuto de Autonomía.

central state and the ACs concerning issues related to the EU. This was also evidenced by their inclusion for the EU Multiannual Financial Framework 2014 - 2020 (Kölling 2015). However, neither the ACs nor the Sectoral Conferences were found to be influential concerning EU's Cohesion Policy meetings. In any case, these conferences are a recent creation and therefore the interactive nature of these conferences have not yet influenced Spain long enough to have had a direct impact on changing the levels of inequality. Yet, in terms of adding to the coordination mechanism available for intergovernmental cooperation, and for attempting to increase both vertical and horizontal coordination, they can be regarded as an important institution. Nevertheless, the relative unimportance of these meetings can be regarded as evidence for low interactive governance in Spain.

5.5.3 Party politics in Spain and interactive governance

In Spain, the relationships of national parties with their regional counterparts played a great importance during the political decentralization process, since the national parties needed the regional parties to form a government. This actually allowed for the regional parties to bargain for concessions for the policies they desired. Concerning the importance of the party politics in Spain on issues related to inequality, one expert claimed the following: "*The party system is more centralized than, say Switzerland. When the same party is in power at the national level and at the regional level, this contributes to the shrinking of the region's autonomy. When the opposition party is in power, they tend to work towards increasing the autonomy of the region.*

At the national level, candidates can try again if they fail, but at the regional level usually they have only one chance"[51].

During the Spanish Socialist Workers' Party (*Partido Socialista Obrero Español* – PSOE) government (1982 – 1993), decentralization enabled regional governments to have the authority to both formulate and implement an extensive range of policies. This also corresponds to a time when there is first a decrease and then an increase in the *Gini* inequality levels. When there are parliamentary majorities of the parties, like the time of the single party government of PSOE, there is actually less consensus style decision making since there are more informal and interparty discussions (Gunther et al. 2004).

The Organic Law of 3/1996, which passed during the center right People's Party (*Partido Popular* - PP) government, is an example of how interactions between parties at different levels raised concerns for inequality. The share of the income tax that would be given to the regions was increased to 30 percent and the ACs would be able to change the tax rates in their regions. This was opposed by regional governments that were under the PSOE control on the grounds of the danger of increasing inequality, which had to be revised in 2001 with the support of all parties. As Gunther et al. (2004) explain, this was possible because PP had a parliamentary majority, and additional transfers of competences resulted from agreements between the PSOE and PP (p.366). PP enacted the Budgetary Stability Law in 2002. When PP did not have to rely on the regional parties and had to meet the EU's convergence criteria, it implemented its own program. "*In Spain, there is a weakness of parties as institutionalized transmission belts of interest articulation between government and society. Party government is*

[51] Personal interview, Barcelona, Spain, February 2013.

made up of weak and antagonistic relations between the cabinet and its electoral-clientele group." (Gunther *et al.* 2004) Also, Convergence and Union (*Convergència i Unió* - CiU), the main nationalist coalition in Catalonia until its dissolution in 2015, was an important player in Spanish politics between 1993 and 2000, the period that saw further decentralization. Especially in the period after 1996, CiU, and Basque nationalist parties collaborated with PP on various issues with the formal "pacts of investiture and governance" on issues such as the income tax that the ACs would receive which could be increased to a maximum of 30 percent, as well as other increased autonomies for the regions. Yet, as McRoberts (2001) argues, the negotiations took place in the Spanish parliament, and not between the governments of the Basque Country, Catalonia and Madrid, which indicates less interactive governance.

5.5.4 Spain and corporatism? Social actors and policy concertation: Bargaining procedures, interactive governance and implications for inequality

Compared to countries such as Sweden and Germany, in Spain, there is generally a relative absence of systemized interactions of the state with social actors concerning issues related to inequality, which contributes to Spain's classification as a non-interactive case. In the case of Spain, it is important to talk about the larger concept of **policy concertation**, rather than just **wage bargaining**, because social actors have played crucial roles in securing other welfare state policies for more social protection, either in addition to or in place of wage compression. As stated in the statistical chapter, centralized wage bargaining and strong union membership should be expected to counterbalance the effect of market forces, which increase inequality (Kenworthy and Pontusson 2005, Glaeser 2006). According to the wage bargaining classification of Kenworthy (2001), bilateral negotiations between government ministers take precedence over centralized bargaining in Spain. Gunther et al. (2004) argue that this dynamic is one of the reasons why public-policy outputs do not reflect the preferences of the majority of people.

"*Overall, the state engineered the whole process of concertation because of the organization fluidity and the adversarial style of industrial relations. While becoming less fluid, Spanish trade unions are not in a position to effectively and systematically influence the decision-making. However "the legitimacy provided by the participation of social partners in the negotiation and drafting of policies has been of the utmost relevance in promoting some of the most important reforms of social protection. The importance of the public sector in the process of concertation is also magnified by the weak institutionalization of social dialogue and concertation in Spain, which makes it highly dependent on the political and economic context as well as state action*" (p. 91)ç

If we explore social concertation from a historical standpoint, during the Franco period, Spanish people did not have institutional mechanisms to channel their demands (Gunther et al. 2004). Mass mobilizations were sporadic and short-lived and ministers who had spending powers were quite autonomous in policy making. Starting with the onset of democratization, policy concertation has played an instrumental role in the development and transformation of the Spanish welfare system but not through established and consistent institutionalized channels that remain to this day in the same consistent effect.

As in other cases of this work, understanding whether Spain has a corporatist structure or not is useful in illuminating the bargaining procedures. Concertation and social pacts in Spain lack some of the structural and institutional prerequisites of neo-corporatism (Molina 2011). Whether Spain is a corporatist or neo-corporatist system is a point of contention (Bermeo 1994; Royo 2002), which would require a peak association with preferential representation or centralized labor market institutions. During the Franco regime, Spain was considered a 'fascist corporatist' state with an inherited Catholic hierarchical tradition, since the trade unions were banned and there were ‘vertical syndicates’ and a “rubber-stamp” parliament, the Cortes (Giner and Sevilla 1984). Looking back, Spain would not be considered a corporatist system in general, yet there have been instances of neo-corporatist agreements in the 1980s, with some breaks, until 1997. Royo (2002) argues that the fact that the Spanish unions are supported by work council elections actually makes the unions stronger. Most strategic decisions are taken at the top union level and there is a high degree of “vertical centralization”. Yet, most wage bargaining that rests on collective bargaining is done at the sectoral/provincial level, corresponding to a medium centralization category. Therefore, in general terms, we can argue that Spain currently does not display characteristics of a neo-corporatist country.

The origin of the fragmented nature of the labor movement lies in the regime transition where the proposition of a single labor confederation was rejected and the representation had to be limited to the biggest companies, and certain sectors (Royo 2002). The peak employer business organization in Spain is the Spanish Confederation of Employers' Organizations (*Confederacion Espanola de Organizaciones Empresariales* - CEOE). There are two large national confederations of the trade unions, which are the Workers’ General Union (*Union General de Trabajadores* - UGT) and the Worker’s Commissions (Communist labor confederation *Comisiones Obreras* - CCOO).

Membership is weak in Spain, however, Molina (2011) argues that they still retain a significant social and political role, and that their collective bargaining and unitary strategies have somewhat been increasing since the 1990s. For example, especially agreements on the stability of employment have showed the importance of social actors in Spain, but the unions are fragmented, stemming from the political, ideological and geographical cleavages and the existence of regional unions (Royo 2002)[52]. Again, we can use this as evidence for the low level of interactive governance in Spain.

Policy concertation and the inclusion of social actors in wage bargaining prevailed in the first years of the democratization process in Spain, whereby the social actors were used to create general consensus about economic policies. Economic issues were very crucial and an atmosphere of consensus prevailed during the constitution writing with the 1978 Moncloa Pacts (Molina 2011), which was signed by all the major political parties, with the participation of trade and employers' associations. During the Moncloa pacts, opposition parties also participated in the process to a large extent. The bargaining process took pace between the centrist parties (UCD government) and the trade unions. In the period of 1978 – 1988, more pacts covering wages followed, signed by the UGT and the CEOE but not the Communist labor confederation (CCOO), refusing to sign most wage agreements (Perez 2000). While these pacts helped wages to be in line with inflationary objectives, real wages were actually stagnant, yet it is also argued that bargaining led to more profitable capital since labor costs went down (Royo 2002).

In the period of democratization, not only wages but also the welfare state policies in general expanded also thanks to the social pacts. There was broad participation by representatives of government and opposition political groups concerning reforms for the regressive taxation system, reflecting the "politics of consensus" of the time. The expansion of social programs made some authors argue whether it was a consolidation of social corporatism in Spain (Giner and Sevilla 1984; Molina 2011). The Socialist Prime Minister Felipe Gonzalez,

[52] UGT and CCOO have different organizational structures for the different governmental levels, with CCOO being more decentralized due to its reliance on work councils.

after being elected in 1983, said that ‘the social forces’ which were organized labor, were also needed as ‘negotiating forces for the government’ (Giner and Sevilla 1984, p. 133). In 1981, there were bipartite union-employer inter-confederal collective bargaining agreements: The 1981 National Employment Agreement and the 1984 Social and Economic Agreement. Also in 1985, the law on trade union freedom was passed with commitments for social spending, unemployment protection, reduction in social contributions and social security reform. In exchange for progressive policies, the trade unions agreed to refrain from striking (Gunther et al. 2004). Giner and Sevilla (1984) argued that, at that time of their writing, while Spain was considered to be a nascent neo-corporatist state, the main elements of a Western style “corporate society” did not actually exist.

As one possible sign of neo-corporatism at the time, in 1985, UGT was invited to the allocation of 10 percent of state’s investment budget due to its collaboration with the government and the CEOE in the so-called neo-corporatist agreement of 1985. Again, the roles of social actors in the ultimate decisions were limited: “*With hindsight, the analysis of the bargaining process shows how the government conceived the social pact as a purely legitimizing instrument, since only some months after the agreement was signed, and in the absence of consensus on pension reform, the government unilaterally passed law 26/1985 that was heavily contested by both the UGT and the CCOO as it restricted pension eligibility*” (Molina 2011, p. 81).

The collaboration of political parties with labor unions ensued throughout the 1980s. The decade of 1980s also witnessed some other neo-corporatist negotiations, between UGT and CEOE in 1989 and 1990 concerning social benefits. Overall, concertation did not bring benefits that were equally shared by workers and wages did not grow (Royo 2002). However, as Gunther et al. (2004) argue, the impact of interest groups was not consistent or institutionalized. They argue: "*The most decisive role of trade unions was in the course of negotiating neo-corporatist pacts with the government but no regulator* ***consultative role*** *aside from* ***infrequent deliberations****. Business, religious and military elites also were like lobbying individual ministers to advance their narrow, special interests*". The social democratic PSOE governments after 1982 did rely on neo-corporatist arrangements with labor, business and government to reduce inflation. Overall, the social pacts in the 1980s did not have social protection as their major concern. More emphasis was given to industrial restructuring, macroeconomic stability, and wage increases. The second half of 1980s witnessed a decentralization of programs where social actors focused on wage moderation costs outweighed social benefits. The 1980s and 1990s also witnessed general strikes in Spain, where there was a pattern of "*weak or non-existent relationship between party and organized interests*" (Gunther et al. 2004, p. 374). Entry to the European Economic Community (EEC) also necessitated more efficiency and there was more reliance on personal income tax. Tax revenues as well as the coverage of the social-security system increased in this period. The high rate of economic growth also coincided with the increase in inequality in Spain, as well as increases in government spending. If we go back and look at the inequality levels in Spain in the 1980s, we see that it is the time when the inequality levels started a decreasing path; therefore there is a parallel trend between the signing of neo-corporatist pacts and decreasing inequality.

In the 1990s, the government pact between the PP and the three nationalist regional parties established a centrist consensus. But as stated earlier, the nature of the relations was more of "bilateral negotiations" between the center and regions. The economic arrangements for Basque County and Navarra were renewed with entry to the European Community, which proved to be difficult with a fragmented bargaining system (Perez 2000). Also, the regionalist parties started to be included in the government in the 1990s, with increased flows from the center to the regions, with those ACs in the slower track gaining responsibilities as well. The period of 1988 – 1995 is described as "universalization despite conflict" by Gunther et al. (2004), due to the absence of social pacts and high levels of conflict, a time period corresponding to the increase in inequality in its latter years. Existing tripartite agreements broke down at this point – and there were strikes due to disagreement over social expenditure policies that fall within the jurisdictions of their respective departments.

Despite the conflicts, Royo (2002) considers the period of 1994 - 2002 as the "resurgence of centralized bargaining". In 1994, the government unilaterally implemented the labor market and welfare state reforms due to the fact that no agreement was reached with the trade unions. In exchange, the Toledo Pact was signed in 1995 to guarantee the sustainability of the pension system, to have a separation between funding of contributory and universal benefits. Also, despite the attempts of **decentralizing collective bargaining**, the trend of bargaining went in the more **centralized** direction. In short, in the 1990s the patterns of policy concertation changed, and as Molina (2011) describes, the welfare state policies became more important than wages for social actors: "*The priorities of actors regarding income redistribution and negotiation patterns have changed dramatically. Since trade unions were mostly interested in their own consolidation, wage compression was included in the packages in the early years of the democracy. During the 1990s, welfare issues were more important for trade unions*" (p.233). The fact that wage issues became secondary can be considered as evidence towards the importance of welfare state policies for social actors, such as pension agreements rather than wage equality.

Since the definition of interactive governance includes different governmental levels and social actors working towards common goals, based on this history of policy concertation, low levels of interactive governance in Spain is closely related to these processes. Gunther et al. (2004) explain why further decentralization in the 1990s did not actually lead to more institutionalization of policy concertation:*"But this overall homogenization of governmental responsibilities across the regions was not accompanied by an institutionalization of multilateral mechanisms of collaboration or in the definition of a common set policy objectives."* (p. 387).

In 2000, labor market reform, collective bargaining, pension system and the reform of the unemployment system was passed. Trade unions also started favoring more flexibility. This was a time when the EU's Maastricht fiscal deficit criteria also had to be met and the necessity of including trade unions in policy concertation was decreasing. "*Concertation in Spain is used instrumentally as a legitimizing device. As soon as the right-wing government attained an absolute majority, there was no longer any need to count upon the support the trade unions and employers' association, and tripartite concertation weakened significantly*" (Molina 2011, p. 87).

As Molina (2011) explains, the period after 2005 can be characterized as a renewal of the social dialogues between the Socialist government that came to power in 2004, trade unions and employers. In the 2000s, during the PSOE government, there was a stronger movement towards more consensus on social policy and labor market issues Some authors regard Spain's post 2000s policy as a return to social pacts or applying **competitive corporatism**, with policy concertation gaining ground once more (Molina 2005; Royo 2002). Again, this shows the fluctuating nature of Spain's policy concertation. However, in the recent periods, unemployment has rendered agreement with the social partners more difficult. Since then, there has been a reduction in number of issues negotiated and there is narrower concertation, and issues have become more regulatory and less distributional. The government and trade unions had other economic and social priorities, such as unemployment benefits, rather than wage bargaining, which are also crucial to income inequality.

Thus, in the period after democratization, governments have relied on social partners to negotiate their proposals but compared to countries such as Germany or Sweden, there is lack of formal channels for concertation as well as the organizational characteristics of the trade unions, the political exchange underlying negotiation process is the crucial dimension to examine (Molina 2011). However, it is difficult to find evidence for a direct effect of the social actors on consistently impacting policies with institutionalized interactive channels that would decrease inequality. Molina (2011) argues that with the challenges against the importance of neo-corporatist theories for welfare state development, looking only at trade union agenda-setting power in Spain and their density would have rendered them weak. He concludes: "*In a country like Spain, characterized by adversarial industrial relations among social partners, the state plays a critical mediating role both in the industrial relations sphere and in the political arena*" (p.91).

5.5.5 Movement towards more interaction?: Spanish Economic and Social Council

A consultative organ where trade unions consult with the government on issues related to inequality is the Spanish Economic and Social Council (*Consejo Economico y Social*), which was established in 1991 as a forum between social and economic partners: The fact that it was not created until 1992 shows that compared to countries such as Spain or Germany, such bodies are a more recent and a more nascent phenomenon and it has not created an institutionalization of policy concertation or social dialogue (Molina 2011). This advisory body to the government is comprised of employees' organizations, trade unions and other representatives of public interests, is a government advisory body which issues opinions on draft bills or laws on socioeconomic or labor policy, whose long term effects on inequality can also be studied.

5.5.6 Quantitative indicators of bargaining: representation and impact

According to the 1985 Union Freedom Act, only the unions that are most representative can be represented at the public administration level, leading to a decrease of small trade unions in Spain. Also there are low levels of representation, more competition at the inter-union level and relatively more decentralized bargaining (Royo 2002). Spain's indicators in the "Data Base on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts, 1960-2014" (Visser 2015) show fluctuations in the coordination of wage-setting procedures after 1977. Between 1977 and 2014, on a scale of 1 to 5, the wage setting coordination scores of Spain fluctuated to a large extent, starting with 5 in 1977, the time when the trade unions started being involved in decision making with democratization. A score of 5 indicates the "**maximum or minimum wage rates or increases** to be determined by centralized bargaining by peak associations", and then continuing with 4 from 1979 onwards for most of the period until the mid 1980s. The score of 4 indicates that **wage norms or guidelines (recommendations) are based** on centralized bargaining by peak associations with or without government involvement, informal centralization of industry-level bargaining by a powerful and monopolistic union confederation, extensive, regularized pattern setting coupled with high degree of union concentration" (Visser 2015). Spain's wage coordination score gradually decreased from 4 to 3 to and then to a 2, which Spain kept from 1987 until 2001. The score of 2 corresponds to "mixed industry and firm-level bargaining, with no or little pattern bargaining and relatively weak elements of government coordination through the setting of minimum wage or wage indexation" (Visser 2015). For most of the decade of 2000s, Spain's wage coordination score had risen to 4 again, before decreasing to 2 in 2009 and then rising to 3 and plateauing at that level, as of 2014. The current score of 3 indicates **negotiation guidelines** based on centralized bargaining by peak associations with or without government involvement, informal centralization of industry-level bargaining and government arbitration or intervention. Therefore, Spain's wage coordination is not as centralized as the first days of the democratization process, but somewhat more centralized than it was for most of the late 1980s and the whole decade of 1990s. Since more centralized bargaining is associated with lower inequality, the fluctuations in these levels indicate a trend that is not favorable to lowering inequality.

Figure 10 below shows the wage coordination scores of Spain between 1977 and 2014.

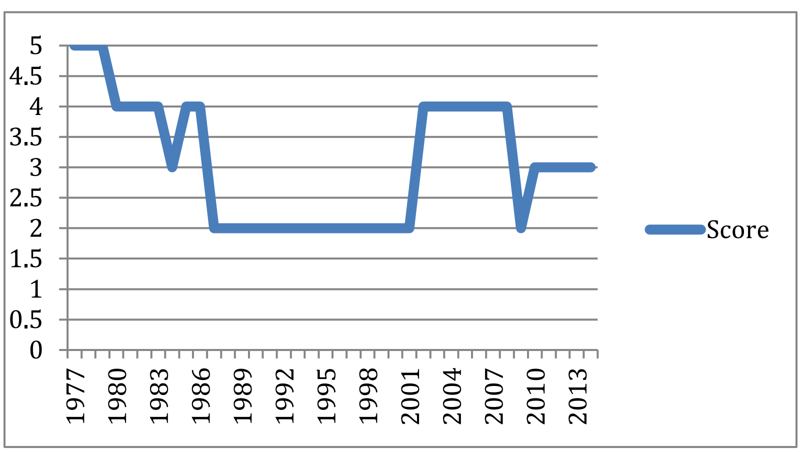

Figure 10. Wage Coordination Scores in Spain

Source: **Visser (2015) Database**
Scores ranging from 0 to 5, higher scores indicate more centralized bargaining

5.5.7 Conclusion: an assessment of the 'interactive governance' level of Spain

As with the other countries, the last subsection of this case study aims at tying it all together: '*interactive governance*' scorecard for the country based on the abovementioned discussion. One of the aims of this dissertation is to create an interactive governance index for each of the countries to be analyzed. The evidence from Spain shows that Spain ranks relatively low on the *interactive governance* index - compared to the other countries in this dissertation in the coming chapters, and I argue that this low level of interactive governance contributes to high inequality to be sustained, according to the theory of the dissertation, based on the evidence in this section. The table below displays the **processes** and **outputs** related to interactive governance in Spain, inspired by the conceptualization in Torfing et al. (2012). This differentiation helps us understand different components of interactive governance in more detail.

Table 8. Interactive Governance Index of Spain

Processes	**0 Low**	**1 Medium**	**2 High**
Identifiable goals – concerning equality in tax capacities and social policy delivery		X	
Vertical: Clear and observed rules of relationships between each subnational government and the central government			X
Vertical interactions (mutual contingencies and interdependencies between different levels)		X Powers devolved to regions at different times and different levels – asymmetry Decentralized implementation and service delivery for most social policies	
Horizontal interactions: Central government's capacity to coordinate among its departments & interactions among different layers		X Sectoral Conferences	
Relying on social partners and compromise	X		
Harmonized and integrated policies at various levels		X	
Outputs			
Goal attainment and distributional effects		X	
Institutionalization and dissemination of revenue collection with equalizing effects		X Intergovernmental grants creating regional differences	

5.5.8 Summary of the findings of the case study on Spain

What do the findings of this case study reveal about the link between the territorial governance structure and national and regional inequality in Spain? This case study looks at Spain from two different angles of the theory of the dissertation: 1) Does Spain's overall decentralized territorial governance structure, and its decentralization of fiscal and welfare state related policies, significantly impact its inequality level as theorized? 2) How does Spain's **interactive governance** level fare, and what does this suggest for Spain's inequality? To recap the argument of the dissertation, I argue that more decentralization, and especially fiscal decentralization, is associated with more income equality, but high interactive governance is significantly associated with lower inequality. If a country has interactive governance, this can offset the forces that increase income inequality in a country, and conversely, if a country has less interactive governance, this would be associated with higher inequalities.

If I evaluate the case of Spain from both angles of this case study, it is possible to see that in Spain, there is at least a commitment to regional fiscal equalization by the central government with different funds and programs. However, in this asymmetric *de-facto* federal state, which has a centrally managed fiscal structure with decentralized implementation, the redistributive policies with asymmetric results fall short of eradicating high **national income inequality** and relatively **lower,** but still **high levels of regional differences and income inequality**. According to the interviews, the fiscal equalization system creates an imbalance at the expense of richer regions considered that they financially contribute more to the system. There is:

a) Duplication of structures
b) Missing effective coordination from the central government
c) Lack of horizontal cooperation

As demonstrated by statistical studies, at the end of the fiscal year, the revenues per person allocated to the poorer ACs, such as Extremadura, are higher than those in richer regions.

This is one of the main points of evidence about how the decentralized governance structure leads to more inequality in Spain. Furthermore, the ambiguities in the Spanish Constitution concerning the relationship between the central government and the regions create room for bilateral relations to be sustained. The 'bilateral' nature of the relations between the central government and the ACs indicates that the relationships between the center and every region is not conducted through the same procedures all the time, paving the way for asymmetry.

While this general finding does not provide evidence for how changing levels of decentralization show a direct impact on inequality levels to change, it is nevertheless illuminative about the general impact of the territorial governance structure on inequality. If we look at the different time periods of fiscal decentralization, the first period following democratization has seen increases in national income inequality according to the Standardized World Income Inequality Database, but as of the early 1980s, the income inequality level is decreasing, until the early 1990s. This time period also coincides with an economic recession, but it is also the time period where all the 'slow-track regions' had also gained their fiscal competences. Therefore, one can argue that the early decades, when fiscal decentralization was being institutionalized in Spain, Spain has witnessed increases in both market and net income inequality.

Adding to this the different dimensions of **interactive governance**, the previous section shows that the impact of social actors – such as trade unions - has been fluctuating concerning issues related to inequality, and that their influence has subsided over the years. However, policy concertation did play a role in the development and of the Spanish welfare system but not through established and consistent institutionalized channels that remain to this day in the same way. The centralization levels of wage bargaining have also fluctuated. Following the definition of interactive governance (Torfing et al. 2012), there is not enough evidence that a plurality of social and political actors that have diverging interests interact to formulate common objectives in a decentered process. Rather, some centrally created mechanisms, such as the Sectoral Conferences, exist, but there is not enough evidence for their contribution to more interactive governance. Regional parties have contributed to matters related to inequality, but there is no repeating institutional pattern of their inclusion. Therefore, Spain's high national income inequality levels are in consistent with the expectations of a fiscally decentralized (but still centrally managed) country with low interactive governance. The following chapters will compare Spain to Germany, France and Sweden, which will allow me to make more generalizable conclusions about decentralization, interactive governance and income inequality.

6.0 GERMANY: FEDERAL SYSTEM WITH EQUALIZING TENDENCIES AND INTERACTIVE GOVERNANCE

Germany constitutes the federal and high interactive governance box in the typology of this dissertation. Germany's federalism results in both the convergence and the divergence of its public policies; therefore a good understanding of Germany's political system is important for evaluating the impact of territorial governance / decentralization, and interactive governance on its income inequality.

To test the theory of the dissertation by demonstrating the impact of territorial governance and *interactive* governance on inequality, this case study on Germany examines 1) the type of 'federalism' in Germany and the sharing of competences as specified in its Constitution (Basic Law), including how its regions - *Länder* - are represented at the federal *'Bund'* level, 2) political, administrative, and financial aspects of its territorial governance structure and an overview of its recent decentralization/recentralization processes, including the 2006 federalism reforms, 3) its national and regional inequality trends over the years, 4) the evolution of the welfare state in Germany, and the fiscal and social policies that have an impact on national and regional inequality, which reflect its federal structure, 5) the features that make Germany a highly interactive governance system, including an explanation of its intergovernmental relations, its **vertical** and **horizontal** coordination practices between different governmental levels and the roles of social actors in wage bargaining matters, and finally, tying it all together: an '*interactive governance'* index for Germany based on the abovementioned discussion. This analysis will also include a look at how the territorial governance structure of Germany allows the *Länder* and the federal government interact for the implementation of the EU regional policies. Qualitative information from interviews conducted in the region of North-Rhine-Westphalia (Cologne and Düsseldorf) and in the capital city of Berlin will also be included in the discussion, as well as data from primary and secondary sources.

Germany's market income inequality (before taxes and transfers) has been on the rise since its reunification. In the 1990s and in the first half of 2000s, Germany has witnessed a substantial increase in its net income inequality (after taxes and transfers) as well. According to OECD (2015), the main increase in income inequality in the recent decades happened in the first half of the 2000s, and this trend reversed in the second half of the 2000s due to various –mainly economic – reasons (Rehm, Schmid and Wang 2014), which I will explore in this chapter. Despite the increases, Germany is still classified as a low to middle inequality country. Overall, the income inequality levels in the eastern and western parts of Germany are now comparable to each other, which I will also touch upon in the following sections of this chapter. Some important questions I attempt to answer in this chapter are the following: Has Germany's territorial governance structure as a whole – its specific type of federalism and its interactive governance – impacted its general income inequality levels over the years? Or are the recent federal reforms significantly related to the increasing income inequality levels in Germany in a dynamic way? In other words, does Germany's territorial governance have a static impact on its national and regional inequality in general, or is there a dynamic impact on changing inequality levels, brought about by the federalism reforms? Throughout the chapter, with the information presented, I will link the German case to the theory and the hypotheses of the dissertation.

6.1 THE CONSTITUTIONAL STRUCTURE: FEDERALISM IN GERMANY AND THE SHARING OF COMPETENCES

Germany is a federal country with specified competencies for all of its levels of government in its Constitution. Germany's "coming-together" federal structure has been classified as "federal-decentralized" (Thelen and Karcher 2012), as "quasi-unitary" federal due to its tax system (Braun 2003), as "cooperative federalism" (Jeffery 2002; Börzel 2002; Gordin 2009), as "executive federalism" (Benz and Zimmer 2012), as "unitarian federalism" (Bendel and Sturm 2010), as "interstate federalism" (Braun et al. 2003), as "federal with a stable equilibrium" (Braun and Trein 2012), "unitary federal state" (Schmidt 2016), "entangled multilevel policy-making" (Kropp and Behnke 2016) and as "joint federalism" (Biela et al. 2013) among many other classifications. Germany's federal structure also exemplifies the "power sharing" and "joint-decision making" model of federalism, as opposed to the "power separation" model of the US or Canada (Braun et al. 2003; Scharpf 2008). In the 1980s, Katzenstein referred to Germany as "a decentralized state in a centralized society" (1987). In this work, I consider Germany as a federal state with interactive governance.

The constitution of federal Germany, the Basic Law, (*Grundgesetz*) establishes the systematized relations between its different governmental levels with an integrated, and in most cases, stable framework. Germany's compatibility between its federalism and its attempts to create solidarity has roots in history, dating back to the Bismarck days (Beramendi 2012). The federal constitution of Germany was proclaimed in 1949, which created the current German federal system. It is based on the decentralized unitary system of the Weimar Republic, which then turned it into a cooperative federalism - and the other types mentioned above (Bendel and Sturm 2010). If we go even further back in history, we understand that the foundation of Germany is also different from, e.g. France: When the medieval feudal order lost power, the result was not a central power concentration in Germany, as it was the case in France (Benz and Zimmer 2012). The Weimar Republic was constitutionally unitary but decentralized with a certain level of the autonomy for *Länder* without real decision-making power at the national level. When the German state was unified in 1871, the outcome was a type of federalism that gave rise to legislative centralization, but also administrative decentralization for the regions (Bendel and Sturm 2010). The current system still carries the characteristics of this legacy, which has important implications for its economic inequality.

The synergy between its parliamentarism, its federal structure and the strength of its local governments are important characteristics of the restored German democracy as well (Benz and Zimmer 2012). After the end of Second World War, the territory of Germany was restructured into several regions, otherwise known as *Länder*, some of which had their historical identities, such as Hamburg or Bavaria. Between 1949 and 1990, the socialist German Democratic Republic (GDR) was in existence. After the fall of the Berlin Wall and the dissolution of the GDR, with the German unification in 1990, the German Federal Republic welcomed five new *Länder*. Currently, Germany has 16 *Länder*, 323 counties and 12,312 municipalities. Except for Bavaria, Hamburg and Saxony (after 1990), the boundaries of the *Länder* do not correspond to historical allegiances (Scharpf 2008; Bendel and Sturm 2010). Some *Länder* have another tier in between as well, called *Landschaftsverbände* in the *Land* of North-Rhine-Westphalia, and *Bezirksvergand Pfalz* in the *Land* of Rhineland-Palatinate. The other level is called *Regierungsbezirke* (district government), which was created in the larger states in West Germany in 1945, and then in the east in the 1990s, to take care of health care, disabled people, culture policies and day care policies within their jurisdictions. Currently, these exist in Bavaria, Hessen and North-Rhine Westphalia. Since North-Rhine Westphalia created regional assemblies for consultation (*Regionalrate*) in 2001, those are considered as a different level as well (Hooghe et al. 2016, p. 379). In this work, I will mainly focus on the Länder as the most relevant subnational level for the application of the theory.

Germany has a bicameral structure at the federal (*Bund*) level, with the *Bundestag* (Federal Diet) and *Bundesrat* (German Federal Council), where the members of the governments of the *Länder* are represented. With the 1871 constitution, Bundesrat became an integral component of the newly unified Germany. The fact that all important pieces of legislation needs majorities of both houses indicates how both chambers actually depend on each other, contributing to the "integrated federalism" (Scharpf 1988). At the subnational level, the *Länder* have one-chamber parliaments, called *Landtage*, which means that there is no other local chamber or level that would have any relations with the *Landtage* (Benz and Zimmer 2012). Except for the city-states of Bremen and Hamburg, these parliaments are elected for five-year periods. The *Länder* governments appoint members from their own ranks to the *Bundesrat*, so the members of the *Bundesrat* are indirectly elected. Parties at both the federal and the regional level are responsible for passing the legislation.

In this chapter, I focus on *Länder* as the main subnational level in understanding intergovernmental relations and the impact of the territorial governance structure on inequality.

German *Länder* have exclusive competences and legislative powers in areas such as local government, police, culture, broadcasting and education (Hooghe et al. 2016). Their most important competence is in the implementation of the federal laws, which focus on keeping the economic and legal unity of the country. According to Article 22.4 of the German Basic Law:

"*The Bundesrat shall participate in the decision-making process of the Federation insofar as it would have been competent to do so in a comparable domestic matter, or insofar as the subject falls within the domestic competence of the Länder*".

As Scharpf (2008) states, since national policy decisions have precedence over regional policy choices; the elections that take place in the *Länder* are considered as 'second-order national elections' where national policies are discussed in the context of regional elections. The intertwinement of the *Bund* and the *Länder* level in policy making has been analyzed with respect to its cooperative tendencies and its promotion of decades long cross-party cooperation, also known as *Politikverflechtung* (Scharpf 1976; Jeffery 2002).

The type of federalism, and *Politikverflechtung* is also very much related to the concept of horizontal fiscal equalization – as will be explained in the next sections of this chapter – stated in the words of Scharpf (2005):

"In combination, the legislative veto of the Bundesrat, the regime of tax-sharing and fiscal equalization, and the proliferation of jointly financed programs constitute the system of 'joint decision-making' (Politikverflechtung) that has become the characteristic of German federalism".

The policy of joint decision-making ensures that the *Länder* are represented at the federal level (Scharpf 1988; Hooghe et al. 2010; Börzel 2002). As Germany's federal structure points out to a "functional division of independent powers", most laws are still passed at the federal level, where both the *Bundestag* and the *Bundesrat* have a say, but then the implementation of these laws are left to the *Land* or local governments (Benz and Zimmer 2012). Arguably, the fact that the *Land* governments do have a veto in *Bundesrat* contributes to more 'interactive governance' in intergovernmental relations, which I will explore further in the subsequent parts of the chapter. If the competences or finances of the *Länder* are at stake, then the *Bundesrat* has to approve those laws with a majority (Benz and Zimmer 2012). Bilateral agreements between regions and the central government, such as those found in Spain, do not exist in Germany, but there is general legislation requiring agreement of the *Bundesrat* or contractual agreements with the consent of all Land governments, indicating more multilateralism and interaction than in Spain (Scharpf 1976). This is also in line with the political culture in Germany, which promotes compromise (Hueglin 2013). Also the fact that *Bundesrat* withstood change during major upheavals of German history also contributed to the relative institutional stability of German federalism (Thelen and Karcher 2013).

Article 31 of the German Basic Law states that "*Federal law shall take precedence over Land law*." However, important mechanisms for negotiation and vertical coordination make this less dichotomous than it may appear. The German *Bundestag* expresses that "*this is intended to ensure that, as far as possible, "equitable living conditions" prevail throughout the federal territory"* (German Bundestag). Therefore, an official proclamation about the equality in living conditions (e.g. public services, etc.) exists in the constitution of Germany (Article 72.2), which is an important element of the discussion on federalism and inequality. When negotiations took place to create the Basic Law of 1949, the richer regions preferred a decentralized taxation system, which was not redistributive to a large extent. However, the negotiations among the party leaders resulted in a constitution that was meant to ensure the equitable living conditions, which was the preference of the Social Democratic Party of Germany (SPD). With this system, Christian Democracy Union (CDU)'s preferred decentralized and less redistributive taxation system did not materialize. This also shows a similarity with Spain, where the left parties represented the interests of those with low-income and worked to ensure a highly redistributive system (Rodden 2010). However, pursuing and promoting common interests has also moved Germany away from cooperation to competition federalism, as Jeffery (2002) argues.

As specified above, arguably the most relevant article of the Basic Law for the theory of this work is Article 72.2. The wording of Article 72.2 has been changed over time, starting in 1994. While the first wording included the ensuring of 'uniformity of living standards', with the changes in 1994, – 'the establishment of equivalent living conditions throughout the federal territory' became a precondition for regulations at the federal level (Schmidt 2016). However, the uniform living conditions are considered also as a 'myth' or a 'paradox' due to policy divergence within Germany and varying economic outcomes in different parts of the country (Jeffery and Pamphilis 2016). The wording of this law emanated from a preoccupation with whether regional inequalities would result in political instability; therefore the drafters of the Constitution made sure to include this principle in the Basic Law (Scharpf 1999; Beramendi 2012).

Yet, the lessening of territorial cohesion and growing disparities can also be traced back to difficulties arising from the implementation of this territorial governance structure. This constitutional requirement allows Germany to ensure more equality in its policies, but how do we explain the divergence of its policies among the *Länder*? Therefore, I ask throughout the chapter: How has this territorial governance impacted, and how can it possibly impact economic policy outcomes, such as income inequality? To apply the theory, the next section explains whether and to what extent the processes of decentralization and recentralization are significantly related to rising or decreasing inequality levels in Germany, and whether we can apply a "dynamic" rather than a "static" look at the impact of decentralization on inequality, and whether the equitable living conditions are indeed a myth or reality.

6.2 FISCAL AND ADMINISTRATIVE DECENTRALIZATION OF GERMANY: IS THERE A PROCESS OF DECENTRALIZATION?

While federal reforms about competences of different levels were passed in the 2000s, the process of decentralization is not a continuously evolving process experienced in other countries like Spain, where the sharing of competences between different levels of government are known to be in constant flux (Colino and del Pino 2011). In Germany, the main federal constitutional structure remains intact; while certain reforms are taking place to change the way the centralized/decentralized German federal structure is held together. As one interviewed expert states, *"Germany is not really in the process of 'decentralizing', so it is not correct to talk about 'decentralization' (as a process) in Germany. Centralization of the (general) system is very important in Germany; it can be regarded as a neo-corporatist structure, with employers' association at the center level"*[53], noting that the recent federal reforms, including those of 2006, did not change the sharing of competences to a large extent.[54] Other scholars, such as Pollitt and Bouckaert (2004), Goetz (2005) and Fleischer (2011) support the idea that Germany did not

[53] Personal interview, Cologne, Germany, February 2014.
[54] Personal interview, Cologne, Germany, February 2014.

experience a large devolution of competencies to lower levels with the reforms of the recent decades.

Against the backdrop of the reforms, Germany's federal state is regarded to be in general equilibrium, unlike countries, such as Spain, with no specific push or pull that necessarily gives *Länder* more powers that will change the distribution of territorial power in a substantial way (Braun and Trein 2012). According to Lehmbruch (2000), there is a path dependency of Germany's federalism, which leads it to stay relatively unchanged.

When the West German Federal Republic was first created, the main force was toward policy "unitarization" until the 1970s, based on the centralized legacy from the Prussian times with a centralized economic policy network. One example for that was how *Länder* gave up their responsibilities of determining the civil servant salaries in favor of giving that competence to the federal government (Lehmbruch 1989). The first important decentralizing reform for regional fiscal autonomy happened in 1966, when the division of the taxes between the central government and the *Länder* took place, to be explained further in the next subsection. With this reform, federal *(Bund*) level could now share the income and corporate taxes with *Länder.*

Currently, the federal government is responsible for the general framework of taxes, and sets the base and the rate of the taxes, but *Länder* can collect the tax as local revenue (Articles 107-108 of the Basic Law). With the reforms of 2006, the *Länder* gained some new competencies, whereby they could have their own management of the penal system as well as determining the opening hours of restaurants and shops, appointing civil servants, determining university law (Articles 74.27, 74.33, Hooghe et al. 2016). Yet, these changes are not regarded as very relevant for impacting the inequality trends.

The first phase of the recent federalism reforms in Germany took place between 2003 and 2006. The first stage of the fiscal federalism reforms was mainly about the reallocation of certain responsibilities between the *Land* governments and the central government. The first constitutional reform (known as Federalism Reform I) was mainly about "disentangling joint decision-making" and transferring certain legislative responsibilities to the *Länder*, such as shop closing times, penitentiary system, civil service career law and civil servants pay, the last of which can have an impact on inequality in the future (Dose and Reus 2016). As Scharpf (2008) explains, the aim of these reforms was "*to increase the capacity for autonomous political action by replacing joint decision-making with the allocation of exclusive competence to both the federation and the Länder*". Auel (2008) argues that the federal reform process of 2006 cannot be regarded as an increase of powers for the federal level, because it has become obligatory for the *Bundesrat* to give consent in all cases if the federal legislation bears any costs on *Länder*. Overall, the legislative competences for *Länder* have increased, which have led to some fragmentations in the laws legislated among the *Länder* due to party position differences (Dose and Reus 2016). Again, going back to theory of this work, more decentralization, such as giving more legislative authority to regions, should be associated with more fragmentation, which in the case of economic policy, can lead to diverging economic outcomes.

Overall, the prevailing view from the interviews I conducted in Germany was also that the federal reforms did not significantly alter the sharing of competences of the different level to make a significant impact on redistributive policies. *Länder* are still able to influence through the *Bundesrat* how inter-territorial redistributions will be implemented (Beramendi 2012). Therefore, rather than an autonomous power, the shared power through the *Bundesrat* is what gives *Länder* the influence especially in fiscal matters. What actually happened with these reforms was that the legislative tasks of the federal and Land level were disconnected further from one another, and the impact of the veto of *Bundesrat* on federal legislation was decreased. So, it is not possible to examine these reforms solely with the dichotomy of centralization/decentralization. Here, before examining it in detail, it is important to touch upon how this would impact interactive governance in Germany: If we think of the *Bundesrat* as a platform for increasing interactive governance, then curbing its veto power could potentially detract from the power of interactions, and giving a new veto power would add to interactive governance. *Länder* were given the authority to deviate from certain federal legislation, and additionally the Article 84.1, which meant that the need for consent for federal regulations on how the *Länder* should implement federal laws was scrapped. At the same time, as stated earlier, a new veto was given to the *Bundesrat* for legislation that bear direct costs on the *Länder*. Looking at all federal legislation made between 1978 and 2016, Stecker (2016) finds that the veto threat of the *Bundesrat* has decreased from 55 to 39 percent, but the consent rate is important for "salient laws" including taxation laws, with a 66 percentage veto threat, considered as high. I will return to this point later on, which highlights the high interactive governance levels for fiscal policy, with a possible bearing on inequality.

In 2009, the *Bundestag* and the *Bundesrat* approved the second stage of Germany's fiscal federalism reforms. According to the new rules, there are new limits for the *Bund* level and *Länder* with a view to reducing public debt (Korioth 2016). With this reform, a new borrowing rule for the *Länder* – the debt brake – is put in place, which is valid as of 2016 at the federal level and in 2020 at the *Land* level. *Länder* in fiscal troubles due to excessive borrowing have taken the federal government to court to obtain bailouts of their debt in the past. For example, in 1992, the Federal Constitutional Court ruled that the federation must provide such bailouts for the *Länder* of Saarland and Bremen. In this second stage of the reforms, the decision makers left the intergovernmental transfer scheme untouched despite different aims in the beginning, leaving the decisions to 2019 (Feld and Baskaran 2009; Behnke and Kropp 2016). Moreover, "Stability Council" has been founded to monitor both territorial levels on indebtedness (Korioth 2016; Behnke and Kropp 2016; Benz and Broschek 2016). The aim is to prevent "excessive indebtedness", and additional transfers will be granted to *Länder of* Saarland, Sachsen-Anhalt, and Schleswig-Holstein, which might create fiscal asymmetry in the system (Feld and Baskaran 2009). *Länder* face different budgetary constraints, but this affects different policy areas differently, and the assumption of *Länder* having equal capacities to supply public services is not always a reality (Benz 2002; Dose and Reus 2016). Kropp and Behnke (2016) argue that the unevenness concerning the competencies, the problems in policy making and fiscal resources were worsened with the reforms. Obviously, the immediate causal impact of these reforms on income inequality is difficult to disentangle. However, the fact that the rise of income inequality has slowed down in the second half of the 2000s is telling, yet this needs to be examined looking at other variables that have an impact on income inequality.

I will return to these reforms at the end of this section where I will look at the changes in regional authorities and competences from a quantitative perspective, and whether they can be matched with changing inequality levels, looking at both qualitative and quantitative data. For this, I present the quantitative indicators of Germany's decentralization over the years below, to supplement the qualitative information presented throughout the chapter.

6.2.1 Quantitative indicators of Germany's decentralization: Regional Authority Index

The quantitative chapter of the dissertation uses each country's aggregated (national) scores of the *Regional Authority Index* (RAI) (Hooghe et al. 2016) in the statistical analysis of OECD countries. In this section, I look at Germany's aggregated and disaggregated RAI scores. **Table 9** below shows the self-rule and the shared rule dimension scores of Germany's *Länder* in the Regional Authority Index (RAI).

For the variables that comprise the **self-rule** elements of regional authority in RAI, Germany's aggregated score is 17.0 for the period of 1950 – 1965, and it became 15.0 after the 1966 federal reforms, indicating a slight decrease in self-rule for the regions. For the variables that make up the **shared-rule** elements of regional authority, we see an incremental increase in the five different time periods, which I will explain. In 1950 – 1963, the overall shared-rule score is 5.5, in 1964 – 1965 it is 6.5, in 1966 – 1967, it is 8.5, in 1968 – 2009, it is 9.5 and in 2010, it is 10.5. Therefore, according to the theory of the dissertation, we can conclude that there has been an overall increase in interactive governance in Germany, as I operationalize interactive governance with shared rule.

Table 9. Self-Rule and Shared-Rule Dimensions of the Regional Authority Index in Germany

Self-Rule Dimensions

Länder (regions)	**1950 - 1965**	**1966 - 2010**
Institutional depth	3.0	3.0
Policy scope	3.0	3.0
Fiscal autonomy	4.0	2.0
Borrowing autonomy	3.0	3.0
Representation - Assembly	2.0	2.0
Representation – Executive	2.0	2.0
Total Self-Rule Score:	17	15

Shared-Rule Dimensions

Länder (regions)	**1950 - 1963**	**1964 – 1965**	**1966 - 1967**	**1968 - 2009**	**2010**
Law making[55]	2	2	2	2	2
Executive control	1.0	2.0	2.0	2.0	2.0
Fiscal control	0.0	0.0	2.0	2.0	2.0
Borrowing Autonomy	0.0	0.0	0.0	1.0	2.0
Constitutional reform	4.0	4.0	4.0	4.0	4.0
Total shared-rule score of Germany:	5.5	6.5	8.5	9.5	10.5

Source: Hooghe et al. (2016)

[55] *Under the variable of law making, the authors report regional representation, regional government representation, majority regional representation, extensive authority, bilateral regional consultation and veto for individual region, and then use an additive index. For the sake of parsimony, I have added those scores myself and reported only the total here.

Now, I turn to a disaggregated look of Germany's regional authority scores, where self-rule and shared-rule elements can be analyzed separately. Compared to another (de facto) federal country, Spain, Germany's RAI scores are much higher, especially in shared rule – showing the difference between a non-interactive and interactive governance country according to my classification - . If we analyze the RAI scores of Germany in a disaggregated manner, among the scores for the variables that constitute the self-rule aspect of the RAI, *institutional depth, policy scope and borrowing autonomy* have remained the same from the first date of measurement until the end.

First, let us look at the variable of *institutional depth*, which measures the extent to which regional governments are autonomous, as opposed to de-concentrated. In 1949, 11 *Länder* gained competences in culture, local government, education and television. The federal government has exclusive competences in immigration and citizenship, but *Länder* implement policies concerning immigration and residence within *Länder*. They have an unchanged score of 3.0 out of 3.0 for *institutional depth*, which means: A non-de-concentrated, general-purpose administration not subject to central government veto. However, as also described above, German *Länder* do not have the full score on *policy scope*, a variable which looks at a range of different government policies in economic, cultural-educational, welfare, institutional-coercive (local policy) and community membership policies (Hooghe et al. 2016). A score of 3.0 for *policy scope* means: The regional government has authority for their own set-up and is endowed with at least two of the following: Residual powers, regional police force, authority over own institutional set-up, authority over local government. Again, the legislative powers of the *Länder* have increased with the 2006 reforms, and perhaps the most relevant for the theory of this work is the competences gained in civil servant pay laws. According to the research of Dose and Reus

(2016), the fragmentation degree is high concerning civil servant pay, where a first-grade high school teacher makes about 62,501 Euros, whereas in Berlin the salary would be about 56,165 Euros. *Länder* that have less budgetary constraints have less difficulty to afford high salaries.

The *fiscal autonomy* scores for the German *Länder* have decreased in the second period covered, in 1966 – 2010. Again going back to the theory of the dissertation, I expect more fiscal autonomy to be associated with more inequality. Therefore, decreasing fiscal autonomy should be associated with lower inequality. Before the 1966 reforms, *Länder* could set the base and rate of income taxes, as well as corporate, inheritance, vehicle and property taxes. With the 1966 reforms, major taxes would now be shared between the federal government and the *Länder*. According to the Basic Law, customs duties, highway taxes, EU taxes and capital transactions taxes are the competences of the federal government, while property, inheritance, motor vehicles, gambling and beer taxes belong to the *Länder*. There are some exceptions, for example, the *Regierungsbezirke* (another governmental level previously mentioned) and *Landschaftsverbande* do not have any independence tax authority. As of 1969, local business taxes are shared with the local governments.

With respect to the latest federal reforms, as of 2006, there is more tax competition as *Länder* can set the rate of real estate tax, based on demands of wealthy *Länder* (Kaiser and Vogel 2016). Generally speaking, competition for the implementation of federal tasks has not been a part of German federalism, unlike the US example. Rather than that, the joint tax system (*Steuerverbund*) and fiscal equalization (*Finansausgleich*) have been applied together, which will be explained in the following sections (Börzel 2002).

In terms of the *borrowing autonomy* component of the self-rule of RAI, *Länder* have a highly autonomous score (3 out of 3) since they can borrow without restrictions, which they mostly do from commercial banks. It is argued that the Article 72.2 of the Basic Law, which stipulates that "the federal government will ensure equal living conditions", leads to low market discipline (Hooghe et al. 2016). Again, this score is important because regional governments can get another source of income without intergovernmental transfers or their own taxes, since 1950. The governments of the *Länder* usually borrow from commercial banks rather than buying bonds (Rodden 2003).

Concerning *representation*, which is the last variable within self-rule, the power of the *Länder* again has not changed, with a score of 2 for both their assemblies and their executives, which is the highest possible score. This indicates that the *Länder* have a directly elected assemblies as well as executives appointed by a regional assembly.

To apply the theory of the dissertation, RAI's **shared-rule** components of *law making*, *executive control*, *fiscal control*, *borrowing control* and *constitutional reform* merit close attention, especially in the case of Germany as a federal state. As far as *law making* within self-rule is concerned, the executives of *Länder* are represented in *Bundesrat*, meaning they have direct influence on policy making at the federal level, but the parliaments of the *Länder* are not represented at the federal level. They get the highest score possible for each component of this variable (0.5), which are regional representation, regional government representation, majority regional representation and extensive authority, and hence get an additive score of 2. However, they do not have bilateral regional consultation. As stated earlier, *Länder* can initiate and veto legislation that affects them. With the 2006 reforms, the co-decision procedure between the *Bundestag* and *Bundesrat* has changed, as previously indicated, whereby Bundestag can enact some legislation without the approval of the *Bundesrat* (Hooghe et al. 2016, Art. 77 of the Basic Law).

The variable of *executive control* within shared rule is of crucial importance for applying the theory of the dissertation to the type of federalism exercised in Germany. There are regular meetings between the *Land* executives and the Chancellor. *Länder* score 1.0 in the first period, and then 2.0 in the following periods, starting with 1964. The score of 2.0 indicates that "*there are routine meetings between the central government and the regional government(s) with legally binding authority*". The main reason for this score is that the intergovernmental meetings became formalized in matters such as regional economy, research and infrastructure, education, social policy, etc. codified in Article 91a-b of the Basic Law (Hooghe et al. 2016). Some of these meetings are also legally binding. I will return to the topic of the intergovernmental meetings *(Ministerkonferenzen* and *Ministerpräsidentenkonferen*z) and their relevance in the section on the intergovernmental aspect of interactive governance. These conferences have emerged as a result of the 1967 Stabilization and Growth Act and the 1969 fiscal constitution reform (Braun et al. 2003). Again, this point does not necessarily denote a move towards decentralization, as far as self-rule is concerned, but instead is more related to increasing shared rule in Germany.

Fiscal control is another important variable within shared rule to apply the theory of the dissertation. As of 1966, *Länder* have power sharing in fiscal control. *Bundesrat* can co-decide the base and rate of taxes and the distribution of the taxes, as well as the financial equalization system (*Finanzausgleich*) (Hooghe et al. 2016). There are also intergovernmental meetings to this end, which I will explore in the section on interactive governance. Similarly, the *borrowing control* variable is telling for understanding the institutionalized economic relations between the federal and the regional level. In 1968, a council for financial planning was created (*Finanzplanungsrat),* where the federal and Land level finance ministers and representatives from other subnational levels participate to coordinate the budgetary plan of the federal level, as well as the implementation of the rules of the Economic and Monetary Union (Braun et al. 2003). The Stability Council, which can create and supervise austerity plans, replaced this council in 2010, with the federal reforms explained in the previous section, where there are members from both the federal and the *Länder* level participate (Hooghe et al. 2016). *Länder* get a score of 1.0 for the period of 1968 – 2009 (regional governments negotiate routinely over borrowing constraints but do not have a veto), and a score of 2.0 (regional governments negotiate routinely over borrowing constraints and have a veto) for 2010 onwards. Before 1968, the score was 0. I will elaborate on the importance of the Stability Council in the section on interactive governance of Germany.

In conclusion, looking at RAI, there is a decrease in the self-rule scores of *Länder,* but an increase in their shared rule elements, with more fiscal and executive control and borrowing autonomy as of the 1960s, and more borrowing autonomy especially as of recently. These increases would indicate a move towards more interactive governance. However, this does not necessarily mean that Germany has become more decentralized over time, since Germany's self-rule elements show a move towards more centralization. Kaiser and Vogel (2016) agree with this point: In their study of 22 policy fields and five fiscal policy indicators, they find that there is not enough of a "critical juncture" (p. 18) for changed competence sharing and that different trends occurred in different policies simultaneously. When the federation was set up, the centralization move originated from a willingness to ensure uniformity in services and resources and the interest in having centralized oversight over the economics of the country (Börzel 2002).

If we do a perfunctory analysis, one can say that increased interactive governance has not averted an increase in the income inequality of Germany. However, as of the latter part of the 2000s, we see an increase in the shared-rule of Germany overall, and that corresponds to a halt in the increasing inequality trend of Germany. Yet, Germany's income inequality is still lower than many other Western European countries, and much lower than another (*de facto*) federal state studied in this work, Spain. However, a more careful analysis, matching the trends of income inequality with changing figures is necessary. For that, in the next section, I present a detailed look of Germany's national and regional inequality trends over the years. I will return to the information presented in this section, after looking at the inequality figures.

6.3 NATIONAL AND REGIONAL INEQUALITY TRENDS IN GERMANY

6.3.1 National income inequality in Germany

Examining the national Gini income inequality scores in Germany, we can see that national income inequality has seen a substantial increase since the 1990s. However, it is still classified to be among the "low- middle inequality" countries in Europe, in the same group as Austria, Belgium, Hungary, Ireland, Luxembourg and Sweden (Gyorgy Toth and Keller 2013).

While analyzing the impact of the territorial governance structure on inequality, it is important to examine other independent variables that have been shown to significantly impact income inequality as well, to control for their impact. Interviews in Germany pointed out to the commonly accepted view that the increase in inequality is "partly because of the incorporation of East Germany to the system of Germany" and that "Germany became like the 'sick man of Europe', with low growth and the overburdening of the welfare state with the increasing of services and transfers".

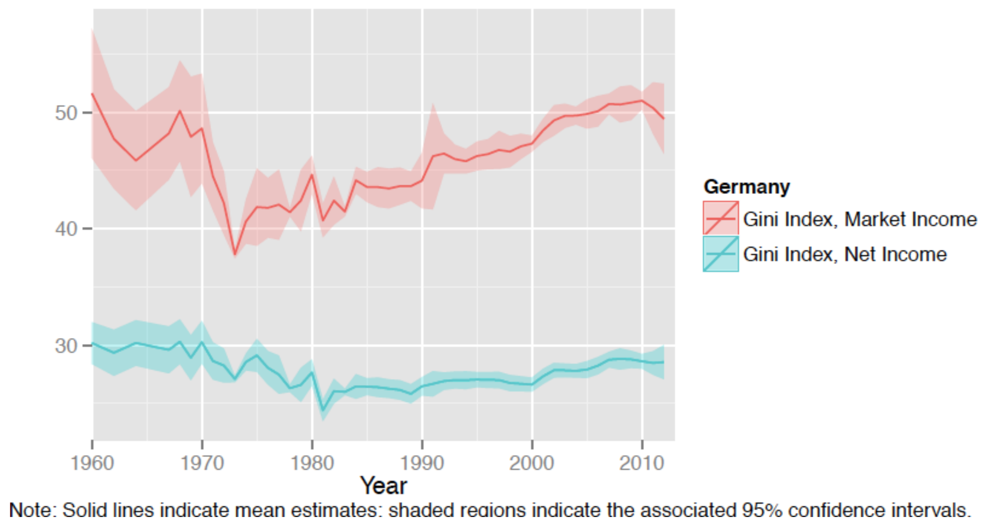

Figure 11. National Income Inequality Levels of Germany (Market and Net Income Inequality)

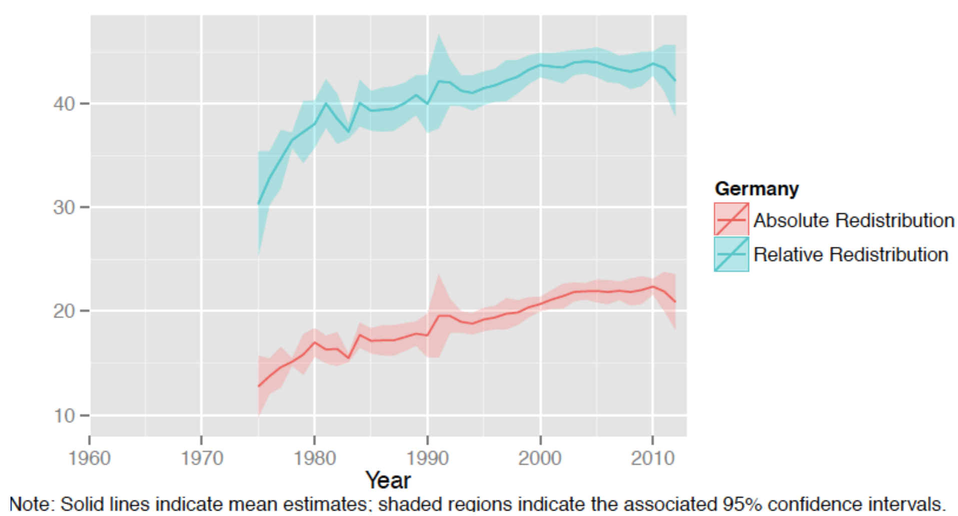

Figure 12. Absolute vs. Net Redistribution in Germany

Gini index range from 0 to 100, 0 indicating perfect equality, 100 indicating complete inequality

Source: Solt (2016)

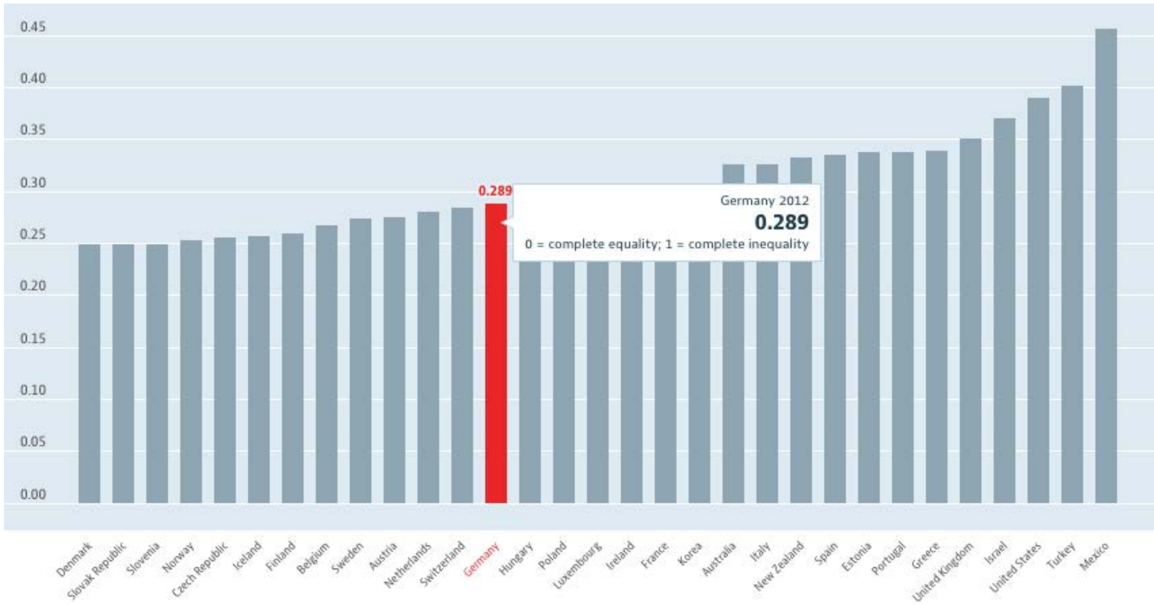

Figure 13. National Income Inequality in the OECD Countries and in Germany in 2012

Source: OECD (2015)

According to **Figures 11** and **12** above, in the 1970s, Germany's income inequality shows fluctuations, but overall a decrease. After a relatively stable amount in the 1980s, the 1990s indicate a spike in income inequality. However, the most visible increase happened as of the 2000s. As Corneo et al. (2014) argue, during the 1980s, the Federal Republic of Germany was quite egalitarian, and only the Scandinavian countries had more equitable income distribution during that time. **Figure 13** demonstrates Germany's position in terms of inequality among the OECD countries in 2012.

The 1980s was a decade of stable inequality, but after late 1990s inequality skyrocketed in Germany. Despite the fact that economic disparities increased throughout Germany, net income inequality levels in Germany did not dramatically increase in the 5 years following reunification (Beramendi 2012). Schundeln, Krueger and Sommer (2010) show that inequality proved to be stable in West Germany until the German unification, but then it increased especially for market incomes and wages after 1998. Furthermore, the unification exacerbated extant problems concerning the uneven financial and fiscal capacities of *Länder* (Benz and Zimmer 2012). As explained in the interviews, '*Solidaritat Zuschlag'* has helped the regions and benefitted the labor markets, helping to better the situation by reducing unemployment. With the Hartz Reforms being put into place in 2004-05, the period people got unemployment benefits was shortened, so that nobody could get the benefits for more than one year. The reforms also changed the social assistance system with a new type of transfer and service being put in place for all job seekers at the level of social insurance. This actually enabled the financial burden to be borne by the federal unemployment agency and this decreased the burden of the *Länder,* yet it still meant a financial burden at the federal level. In the words of an interviewed expert:

"Care was taken to avoid regional inequalities between different Länder. Whereas in the past the employment agency had to find applicants a job at the skill level of the applicants, now the job seekers were obliged to take the job below their skill level if the agency matched them with a job. This meant that there was an elimination of 'Arbeitslosenhilfe' and the elimination of the threshold of the formal skill level requirement. While this can be regarded as a positive move towards securing more employment, it also increased low wages and 'atypical employment', also paving the way for higher overall national inequality".[56]

Therefore, in the 1990s, income inequality did not immediately increase, as Eastern Germany had more even income distribution, and it did not translate into skyrocketing inequality in the first years (Benz and Zimmer 2012).

One important factor mentioned in the interviews was that the changing nature of employment in Germany – related to the concept of the dualization of the labor market - has

[56] This insight was provided by experts in the personal interviews conducted in Cologne, February 2014.

given rise to income inequalities as of the 1990s, as it has done in other developing and developed nations. This means that there would be more accentuated differences for those with full-time jobs and benefits and those that did not have them. Unemployment had risen after the German unification of 1990 and the decade of 2000s saw unemployment rise generally, going from 7.6 percent in April 2001 to peaking at 11.2 percent in August 2005 (Eurostat). In the last two decades, the labor market has been deregulated in many European countries, including Germany, with the rise of short part-time contracts (Bonoli and Natali 2012). According to Dustmann et al. (2009), wage inequality has increased in Germany for the upper half of the distribution during 1980s and 1990s, and they attribute this to the technological changes and the occupations at the top growing faster. However, for those at the lower half of the income distribution, the wage inequality increased only in the 1990s and the authors attribute this to declining unionization and increasing low-skilled labor after the unification (Dustmann et al. 2009). On this topic, Streeck (2015) argues the following – which I will return to in the section on interactive governance:

"Since unification, public employers, in pursuit of fiscal consolidation, have broken up Germany's peculiar public sector collective bargaining regime, which covered everyone from refuse collectors to professors and generated, essentially, the same yearly wage increases for all. Moreover, several occupations – including train drivers, teachers and postal workers – lost the uniquely German employment status of "Beamter" of civil servants without a right to strike but with lifelong tenure and guaranteed pay raises in line with the rate of economic growth."[57]

[57] Another highlight of the interviews was the discussion of minimum wage in Germany: What would happen if Germany introduced minimum wage? It has since been introduced as of 2015.While some experts argue that it would help reduce income inequality, others argue that it would help increase inequality because it will be too expensive for certain employers. One argument against minimum wages in Germany is that the labor market will not be able to naturally deal with this and the jobs would go away. On the other hand, the argument for pro-minimum wage is that more people will have a job where they can make a living. However, the differences in the living costs will naturally mean the minimum wage will not have the same impact everywhere in the country.

For the increases between 1999 and 2005, changes in the tax system are culpable for changes in inequality, as expected, according to Biewen and Juhasz (2012), in addition to other variables I mentioned, such as unemployment and rise in atypical employment and the dualization of the market and an increase in the distribution of labor incomes. OECD explains this further with figures. The increase in income inequality in Germany was higher between 2000 and 2005 than all the preceding 15 years (1985 – 2000) combined, and this increase is attributed to changes in the labor market and changes in the structures in the households. As far as the redistribution is concerned, taxes and benefits had a redistributive effect and did lead to lower net income inequality figures in Germany than market income inequality, but still not sufficient to stop the rapid increase of inequality in general. Also, OECD (2008) shows that certain social policies, such as public health, public education or public housing did not lead to a substantial decrease in inequality in Germany as they did some other OECD countries. The maximum marginal tax rate decreased gradually as of 1999, from 53 percent to about 42 percent in 2007-08, according to German Ministry of Finance. In 1997, the imposed “rich-tax” reversed the reductions for tax-payers for those that were at the top end of the income distribution. However, as Biewen and Juhasz (2012) show, the inequality in labor market incomes at the household level and the changes in the employment structures were of greater importance than government policies.

The rate of the increase of national income inequality slowed down as of the mid 2000s, and it has shown a stabilizing tendency as of 2007-08, and a halt as of the 2010s, with an increase again in 2012 as **Figure 14** shows below. While this trend matches an increase in interactive governance, especially with respect to the setting up of new intergovernmental mechanisms, such as the Stability Council in 2010, we need to look carefully at different variables in order to significantly tease out the impact. Furthermore, the increase again after the year 2012 merits attention. Grabka and Goebel (2014) argue that changes in inequality in market incomes, which include capital incomes, are the main factor behind this increase after 2011. Using factor decomposition of the Gini coefficient, Rehm et al. (2014) show that the distribution of capital income was the main factor that led to the sharp increase in inequality in the early 2000s, and the reversal of this trend was the key reason of the reversal in inequality trends as well. However, labor market reforms were also found to be of key importance, which I will elaborate on later in the chapter as well. According to Biewen and Juhasz (2012), the changes in the equalization transfers, as a part of the Hartz reforms in 2005, had an inequality reducing effect, despite the conventional view that they actually increased inequality. These reforms brought a new unemployment benefit in lieu of the previous means-tested unemployment assistance and social assistance payments. For this very reason, one should exercise caution before attributing causality to the reforms and other policies for inducing inequality, and also remember that policies might take some time before showing their actual impact on inequality.

Overall, Germany's market income, including capital income is uneven, and about 60 percent of the population is on the receiving end from the government, and about 40 percent of the people are on the paying end, and that the main government redistribution comes from the statutory pension system (Bach 2015)[58].

[58] Bach (2015) goes on to say that the statutory pension system does not constitute significant redistribution if you consider the payments one make over his lifetime, so the redistributive effect of the tax and transfer system decreases by half if the pension payments are taken out.

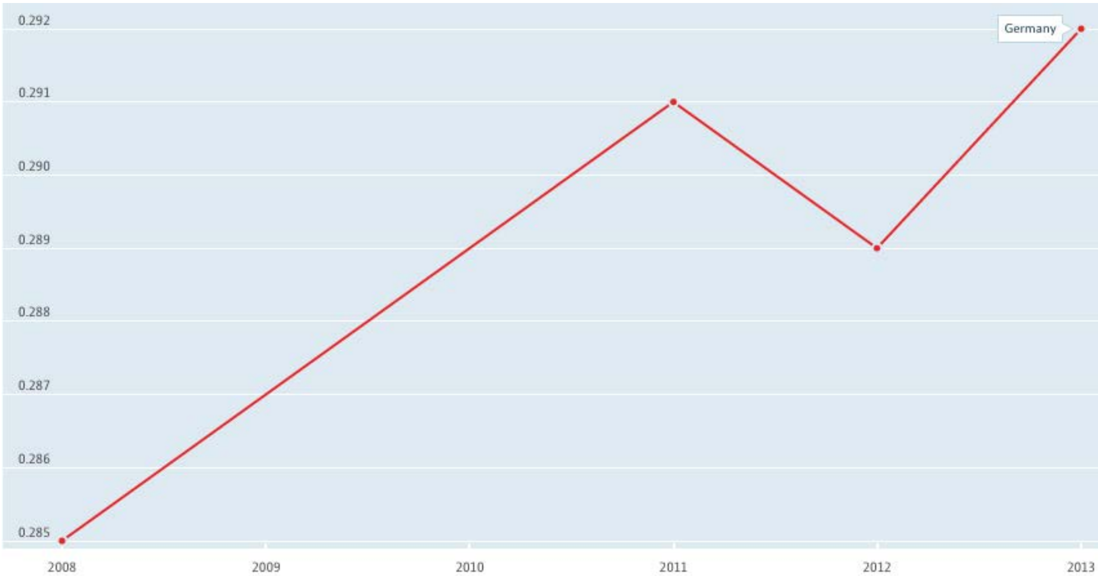

Figure 14. Net Income Inequality in Germany, 2008 - 2013

Source: OECD (2017)

Gini index from 0 to 1

6.3.2 Regional inequality in Germany

In addition to national inequality scores, regional inequality scores are also important. For example, the per capita gross domestic product (GDP) in Germany is substantially higher in the western part of the country than in the East – despite the trend after 1990 towards more equalization. As **Figure 15** shows below, the purchasing power standards (PPS) per inhabitant as a percentage of the EU-27 average for the year 2010, in terms of the EU-NUTS2 regions is substantially different between Mecklenburg-Vorpommern with 83 percent of the average, and Oberbayern with 204 of the EU-27 average. However most of the regions in Germany are above the EU-27 average.

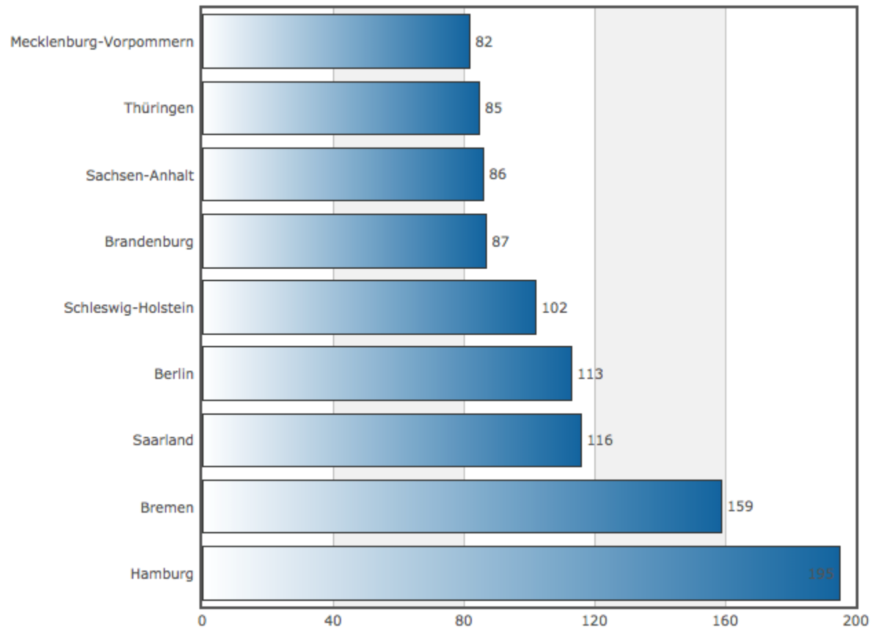

Figure 15. Regional Gross Domestic Product of German Regions in Purchasing Power Standards in 2010

Source: Eurostat, European Commission

According to Beramendi (2012), with the reunification, average level of market income inequality increased about 3 percent in all *Länder*. Research shows that there are large levels of interpersonal redistribution from West to East. However, Frick and Goebel (2005) show that on the whole, there is no evidence for an increased regional convergence in inequality. During the reunification and the creation of the Solidarity Pact in 1993, *Länder* that contributed to the interregional redistribution obtained a stronger institutional position in terms of the distribution of seats in the *Bundesrat*. A decade after the reunification, the conditions that would prevent too much redistribution from richer to poorer *Länder* were finally arranged after various reforms to the Solidarity Pact, most importantly in 2005. The reunification also prompted a tendency for more centralization to be able to implement big reforms, since the *Länder* that were on the receiving end of fiscal equalization increased from 5 to 11 (Behnke and Kropp 2016). In the East, after the unification, the gross incomes were distributed more unequally at the household level, but with government redistribution they became more evenly distributed than the West (Corneo et al. 2014), but this difference has lessened in the recent years.

6.4 WELFARE STATE IN GERMANY AND FISCAL AND SOCIAL POLICIES RELEVANT FOR INEQUALITY

Germany is considered as a conservative welfare state, where rights have traditionally been attached to class status, with clear differentials in terms of benefits and rights (Esping-Andersen 1990). Germany is considered as an example of the compatibility between federalism and all-encompassing welfare state, sometimes referred to as "conservative corporatist" or during the 1980s, a "corporatist variant of capitalism" (Obinger et al. 2005; Manow 2005; Corneo et al. 2014).

It is important to understand how the welfare state came into being and how it was transformed for understanding the impact of decentralization on inequality to apply my theory, and to test the hypotheses on how the territorial governance structure impacts inequality. In Germany, the welfare state was used in order to increase the power of the central government vis-à-vis the regions (Manow 2005; Beramendi 2012); therefore the balance between decentralization/regionalization and centralization go hand in hand.

As a part of the continental European welfare state categorization, it is important to note that Germany has a welfare state regime, where the state did not establish the social insurance mechanisms in the beginning, and which were mostly provided by the firm or industries – as was also seen in the case of France. With the creation of solidarity associations, the employers realized that in order to protect their interests, it was useful to have some social insurance schemes. The German “occupational social insurance funds” (*Kassen*) were created which were not profit and administered by employee and employer representatives (Palier 2010), mainly for male workers in the industry. Again, as presented in the case in France, these schemes did not target poverty or inequality, but rather aimed at an equalization of benefits with respect to wages (*Aquivalenz-Prinzip*) (Palier 2010). Since the Imperial Chancellor Otto von Bismarck started most of the reforms in the 1880s, this welfare state type is referred to as *Bismarckian*. Some of these reforms include the initiation of sickness insurance in 1883, compensation for workers for industrial accidents in 1884 and the creation of pensions for old-age in 1889 (Hancock and Krisch 2009). Again, this was related to the creation of a unified German state. As Manow (2005) explains: “*Less well known is the fact that the foundation of the German welfare state between 1883 and 1889 was also a large-scale exercise in nation-and state building*” (p.226) and that “*the German welfare state indeed has become the great national unifying institution state*” (p.261).

The conflicts among the class were planned to be prevented by the Bismarckian welfare provisions, which were overall managed by the central state but financed in a decentralized manner and administered by the employers and employees (Benz 2002). Yet, it should be noted that social partners wanted to keep management autonomy and self-financing of the social insurance schemes they ran due to a distrust of the authoritarian state (Palier 2010). This can also be explained with the evolution of German federalism, according to Thelen and Karcher (2012), where they argue that the public debates center on the inability of federalism to provide the same type of living conditions, and people’s dissatisfaction if this level is not provided by the state in Germany.

The fragmented nature of the welfare state persisted in Germany, while it became more universalized. In the 1920s, during the Social democratic reign, white-collar employees also gained social benefits and unemployment insurance. As Palier (2010) argues: "*Social insurance schemes are less an arena of industrial conflict than an instrument of social partnership designed to address the issue of the social and political integration of industrial workers – the Arbeitfrage in German - (la question sociale in French – and a guarantee of social peace*" (p. 604). Also, the totalitarian regime expanded the benefits so that health care and retirement benefits could be supported, in order to mobilize support. In the 20th century, Germany secured the "German Model" (or known as *Modell Deutschland*) where some of those benefits were retained (Hancock and Krisch 2009), which was characterized by a social market economy with less intervention than France or less coordinated policy making than Sweden (Ibid 2009). Germany's taxes were reformed in 1920 when taxation became a central government competency and the central government's revenue autonomy increased (Beramendi 2012). Overall, the German welfare had two tiers, which largely distinguished between the poor and the workers, and a small portion of the society depended on social insurance (Seeleib-Kaiser et al. 2012).

The current German welfare state is considered as a mix between the minimum standards provided by the *Bismarckian* model, coupled with the Christian-Democratic and Social Democratic measures that were taken after the Second World War, for both individual and collective security, where private capital is also represented (Hancock and Krisch 2009). The overarching point of the interviews I conducted about the German welfare state was the following: an attempt at a near complete equality prevails in Germany and that the federal government strives to equalize regional differences and living conditions among different regions as much as possible, also paving the way for lower national interpersonal inequality (Braun et al. 2003). It is exactly a blend of this equalization principle and the qualifications by different income-groups to the welfare entitlements. Employers, employees and social contributions make these entitlements (Hancock and Krisch 2009). Richer people prefer the privately funded health care programs in Germany. The dualization of the labor market, which is seen in many other European countries has also taken place in Germany, with the rise of lower-paid, part-time and unstable jobs, which was expressed as a reason of increasing inequality (Corneo et al. 2014).

Germany also has had its own share challenges to combine equal living conditions and diversity. The constitutional ideas such as "*Bundestreue*" (federal loyalty) and the equivalence of living conditions (*Gleichwertigkeit der Lebensverhältnisse*) can be found in the Basic Law, but how to federally ensure that has always been an important challenge (Behnke and Kropp 2016). Therefore, the re/decentralization of the welfare state policies is important for applying the theory of the dissertation.

Germany's financing system of its social insurance and generous pensions, as well as formalized and institutionalized governance structures with several veto players favoring the status quo and its bicameral structure make it harder to implement welfare state reforms in Germany, resulting in what is called *Reformstau* (reform deadlock) (Hemerijck 2013; Esping-Andersen 1990; Pierson 2001). The power-sharing type of federalism calls for a division of power in policy-making between different levels of the government, and there is an organic division of labor that necessitates "interdependence" in policy-making in Germany (Braun et al. 2003). Germany's federalism is also referred to as an "interlocked" intra-state type of federalism (*Verbundföderalismus*) where institutions at the federal level have joint jurisdiction: and this might “not necessarily have a constraining impact on welfare state growth” (Manow 2005). In the 2000s, four reforms, known as the Hartz reforms, were implemented in Germany, which led to important changes in the labor market and unemployment insurance, with the creation of activation and the earlier mentioned increase of low-cost and atypical jobs, often linked with rising inequality (Palier 2010).

Based on these complementary but varying views on the German welfare state, in order to understand the impact of the territorial governance structure, re/decentralization policies and the federal reforms on inequality, it is now necessary to look at specific fiscal and social policies to apply the theory of the dissertation.

6.5 FISCAL AND SOCIAL POLICIES IN GERMANY AND FEDERALISM

This section explores the main fiscal and social policies that matter for inequality in Germany, starting with the tax system. According to the Article 109 of Germany’s Basic Law, the federal level and the regions can decide on their own budgets given that they oblige with some principles. Labor market policy, defense and social security are the competences of the federal level, as far as the budget expenditure is concerned. On the other hand, education, internal security, justice, and last but not least, tax administration comprises the expenditure of the *Länder*. 90 percent of the government revenues come from taxes and social security contributions (Bundesbank 2014). The creation of the social policies does not lead to considerable contention, but their funding does, since there is a need to ensure equal levels of resources (Beramendi 2012).

There has been increasing research on the convergence and divergence of policy making in German *Länder*. Here I consider this point with respect to the type of federalism that is exercised in Germany, and its interactive governance. According to Schmidt (2016), the main variables that lead to divergence in terms of policy making in the *Länder* are results of different party compositions in the *Länder*, party competition among the major parties at the federal level for welfare policies, the power division between the federal state, the *Länder* and the EU, as well as the policy constraints placed upon the *Länder*. For example, the role of Bavarian Christian Social Union (CSU), as a party that agrees to form a joint party group after the general elections, accentuates their support for the more federalized character of the Christian Democrats in general. As Benz (2016) argues, "*not only is the CSU a regional party, rooted in a single Land, it also exerts particular influence on federal politics visa this specific partnership with the CDU, a federally organized, but "state-party."*

Jeffery (2002) argues that while Germany did not implement the same scale of neoliberal reforms as the UK or the US, starting in the 1980s, the fact that there has been a "roll back of the state" also accentuated territorial interests among the *Länder*, against the backdrop of reunification and widening disparities.

6.5.1 Fiscal policies: taxes, redistribution and the financial equalization system in Germany

Overall, the quite centralized fiscal structure of Germany rests to a large extent on its economic geography, but also shows a clear continuity with its pre-unification times (Beramendi 2012). In Germany, the fiscal equalization scheme supposes that the level of public services should be the same throughout *Länder* based on Article 72 of its Basic Law. Looking back, according to Scharpf, Reissert and Schnabel (1976), the diversities of the West German *Länder* in terms of fiscal and administrative capacity, as well as economic conditions, were dealt with both by the fiscal regime, namely the vertical and horizontal 'fiscal equalization' transfers, but also by the "jointly financed and planned programs" (*Gemeinschaftsaufgaben and Finanzhilfen*) in politically salient policy areas, such as regional economic policy, higher education, basic and applied research, social housing, urban renewal, etc.

In the words of an interviewed expert, "*Centralized welfare state reform tackles inequality and there is solidarity at the local level in Germany*". Generally speaking, the idea of uniformity between the *Länder* and the idea of central equalization is still in place to a large extent - also based on the Basic Law -, at least as a goal, and tax issues are always decided at the central *(Bund)* level. While the federal level decides on the tax rules, the *Länder* do not have the authority to propose tax legislation. Yet the tax administration is decentralized, meaning there is no such centralized institution like the Internal Revenue Service in the US.[59]

In other words, while the *Länder* do not have financial autonomy for determining the tax levels, it is also argued that there is an intense bargaining process among different levels for fiscal matters. Therefore, going back to the main theory, the fact that the *Länder* can represent themselves at the *Bund* level for fiscal matters shows a higher level of 'shared-rule', as seen with the variable of fiscal control. Also, one argument is that, on the overall, *Länder* do not actually want more (fiscal) autonomy, since that would create more cost burden on the poorer *Länder*. Therefore, the economic and administrative disparities have led to the preference of co-decision

[59] Personal interviews, Cologne, Germany, February 2014.

– through the Bundesrat – as a response to further centralization, rather than co-determination for the *Länder*, and since the creation of post-war Germany, smaller *Länder* have not supported a territorial reorganization that would transform this system (Börzel 2002).

"*Although the tax system is often quoted as the most representative constitutional elements of the quasi-unitary nature of German federalism, it is paradoxically also the feature that keeps the 'federal game' going, and this despite the fact that tax policy is dominated largely by party politics'. The tax system is formally rather centralized, but in reality it is based on a delicate balance between central and decentralized powers*" (Braun et al. 2003, p.86).

Therefore, the tax system in Germany is an important part of its federalism, due to the importance of both horizontal and vertical equalization. As in other states, there is need for fiscal equalization due to economic, administrative and fiscal disparities among the *Länder*. In Germany, tax revenue from VAT is dedicated mainly to inter-regional redistribution (Bordignon 2010), indicating high commitment to horizontal equalization with egalitarian goals. In Germany, there is a blend of a joint tax system (*Steuerverbund*) and fiscal equalization (*Finanzausgleich*).

The resources in Germany are allocated according to two different systems, which are the *Trennsystem* and the *Verbundsystem*. These were created wıth the financial constitution reforms of 1969. The separate *Trennsystem* comprises of 30 percent of all the tax revenues in Germany, fed by all the territorially run taxes. For example, within this system, the regions tax on the personal wealth tax, motor vehicle tax, beer tax, real property tax, etc., while the federal level can collect bigger taxes such as insurance tax, investment tax, custom duties, stock exchange tax and transaction taxes among others (Beramendi 2012). The 70 percent of the total fiscal revenues come from the federal level *Verbundsystem*, which is supposedly uniform across the territories, but Beramendi (2012) argues that not all the regions have political input in the design, despite the fact that the Bundesrat gives them that opportunity. Within the *Verbundsystem*, personal income tax is shared between the federal level (42.5 percent), regional (Land) level 42.5 percent and local governments (15 percent), while corporate income tax is shared evenly between the federal land the Land level. The VAT is mainly at the federal level with 52 percent, and the rest is collected at the Land level (German Federal Ministry of Finance 2015). VAT generates most of the revenue among all the tax types.

The two fiscal equalization schemes are a part of the *Verbundsystem*, divided into two dimensions: *Primarer Finanzausgleich*, which vertically distributes all the revenues among the federal (Bund) level, *Länder* and municipalities, and the *Sekundarer Finanzausgleich*, which makes horizontal equalizations between the richer and poorer *Länder*. The whole financial equalization system can be summarized with the following four stages (German Federal Ministry of Finance 2015):

1) **Vertical distribution**, where the whole tax revenue is distributed to the Bund (federation) level and all the *Länder*, where the local authorities also receive a supplementary grant.

2) **Horizontal distribution**, where the portion of the tax revenue from the *Länder* is given to the various *Länder*, with an equalizing effect,

3) **Financial equalization** (*Finanzausgleich*) between poor and rich *Länder*, where the share of joint taxes and the tax revenues of the *Länder* are taken into account,

4) **Supplementary federal grants** for the poorer *Länder*.

The third stage is an important part of the overall equalization system. As explained in the interviews, for example, if there is originally a 120 percent – 50 percent per capita fiscal difference between the *Länder,* after the financial equalization, it is closer to a difference, such as 105 percent – 95 percent, but the ranking of *Länder* is not supposed to change, as inadvertently experienced in Spain.[60] Also, according to the German Federal Ministry of Finance (2015), if a fiscally weak *Land* has a financial capacity per capita which is around 70 to 90 percent of the mean, after the fiscal equalization system is, it gets to 91 or 96 percent of the average. For a fiscally stronger Land that has a capacity of 110 to 120 percent of the mean, the aim is to bring it to 104 to 106.5 percent of the mean. Again, the principle of having the same fiscal capacity per capita is applied, except for the *Länder* of Berlin, Bremen and Hamburg, which are considered as city-states and have higher requirements per capita. Similarly, three *Länder* that are more sparsely populated have less financial requirements per inhabitant. The city-states are simultaneously both local authorities and *Länder* in their own right. They have a much higher financial requirement per inhabitant than the normal Länder (35 percent more per capita). *Länder* of Brandenburg, Mecklenburg-Western Pomerania and Saxony-Anhalt are sparsely populated and their populations are also increased notionally in the financial equalization system, similarly to the city-states.

According to the financial equalization principle of Germany, the distribution of the VAT is flexible, meaning that if there is a fiscal imbalance, *Länder* can ask for a larger share of the revenues (Braun et al. 2003). VAT is not allocated according to place where it is collected; it is rather done on a per capita basis, which creates an equalization effect.

The share of the *Länder* of the VAT is distributed among the *Länder* based on the number of inhabitants. If some *Länder* get tax revenues below average, they get additional shares

[60] Personal interview, Cologne, Germany, February 2014.

through this system, which already has equalizing effects. However, in the views of some interviewed experts, this can also lead to inequalities: "*Income and corporate taxes are allocated to where they are collected, and this favors rich areas.*"[61]

Net recipients from the fiscal equalization system are reluctant to accept changes in the fiscal equalization system, since that would confer more responsibility upon the *Länder* (Braun et al. 2003). Again, Börzel's (2002) point becomes relevant here: *Länder* do not prefer more tax autonomy and ask for the continuation of the financial equalization scheme. As the centralized welfare system until recently prevented the emergence of substantial economic competition, there is especially low support for more devolution to regions in terms of fiscal autonomy (Manow 2005). Feld and von Hagen (2007) argue that an increase in tax autonomy could be possible, if common fiscal responsibilities could be decreased, or if *Länder* also gained legislative responsibilities.

Manow (2005) argues that political actors have extensive redistributive aims and they "superimpose" nation-wide tax and transfer systems on still federally fragmented political accountability structures, so this changes the interplay between federalism and the welfare state. Federalism does not hinder welfare retrenchment but makes it difficult to make reforms:

"*It is hardly surprising that German federalism has not prevented the Bismarckian welfare state from becoming one of the world's most expensive, generous and encompassing systems of social provision and its favored revenue-collecting mechanism a para-state within the state. Contrary to the received wisdom of the federalism thesis, federalism has also not prevented*

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[61] Personal interviews, Cologne, Germany, February 2014.

substantial retrenchment in the era of the new politics of the welfare state" (Manow 2005, p. 262).

As can be expected, the sharing of competences and the assignment of revenues to different levels of government reveal the federal conflicts.[62] The distribution of personal and income taxes are determined in the constitution, however the Value Added Tax (VAT) can be negotiated, which indicates a strong central steering with some room for flexibilities, which could be used to correct vertical imbalances (Braun et al. 2003).

Extant work and insight from the interviews show that the balance between fixed and flexible elements of the Constitution and the federal structure exist to offset the imbalances, since *Länder* are allowed to request a larger share of VAT revenue if they can show a vertical imbalance, that is if the tax coverage of their expenditures is below the tax coverage ration at the federal level. During the third stage of the federalism reforms in 2009, further discussion on the reform of the vertical and horizontal equalization scheme was postponed, using the existing intergovernmental meeting features. Bavaria and Hesse continued their demands for a horizontal equalization scheme that was going to be less redistributive. Overall, there was consensus despite regional differences between *Länder* led by different governments to transform the horizontal fiscal equalization system with a new tax revenue distribution system, which is yet to be accepted by the government and put into place (Detterbeck 2016).

In addition to the financial equalization instruments, the redistributive role of the welfare state in Germany also rests on social policies. Concerning social policies, the generally promoted policy of providing equal resources to every inhabitant throughout the different territories can

[62] For example, in 2013, Bavaria and Hesse had a suit impending before the Constitutional Court, challenging the system of tax transfers, to stop subsidizing spending in the city of Berlin and other poorer states.

result in the funding or administration problems of these policies at the subnational level (Beramendi 2012). Now, I look at two social policies in Germany, which are important for the discussion of decentralization of the welfare state and income inequality: Labor market policy and unemployment insurance.

6.5.2 Social policies: labor market policy and unemployment insurance

Overall, the social policies do not have a decentralized nature, which could theoretically result in substantial regional differences to pave the way for more inequality. Germany, along with Sweden has implemented first a decentralized and then a more centralized active labor market policy (Hemerijck 2013). To explain how the specific type of federalism impacts social policies in Germany, an expert expressed the following: "*Unlike Spain, the Länder in Germany are not as relevant for determining the competences, but they are influential in implementing the decisions. For example,* ***labor market policy*** *is under federal law and it aims at integrating unemployed people and migrants into the labor market. There are special programs – active labor market policy - by Länder, especially in those where there are social democrats are in power. These kinds of policies can be compared to the ones in Sweden. These policies do not cost much money to the Länder and they concern Länder more at the 'implementation' stage of policy making.*"[63]

Unlike Spain, the *Länder* in Germany do not have the relevant competences for policies regarding inequality, however they implement decisions. For example, labor market policy is under federal law and it aims at integrating unemployed people and migrants into the labor

[63] Personal interview, Cologne, Germany, February 2014.

market. There are special programs – active labor market policy - by *Länder*, especially in those where there are social democratic parties and the eastern *Länder*. At the local level, municipalities are important for designing market policies – services and infrastructures. For example in Dortmund, the antipoverty policies are implemented at the local level, related to the increase of local discretion with the Hartz reforms of the 2000s. These reforms had an impact of shortening the eligibility of unemployment insurance.

In Germany, unemployment insurance is administered at the federal level by the Ministry of Labor and the Federal Employment Agency. Overall, the rates of contribution and benefit entitlements are uniform throughout the country. Other types of income support programs, such as sickness insurance and other family related benefits are funded by taxes, and this time, administered both by the federal and the regional governments (Beramendi 2012). After the World War II, the replacement rates provided through the unemployment insurance gradually increased in corporatist countries, including Germany, especially after the 1957 laws during the Adenauer government (Sjöberg, Palme and Carroll 2010). At the same time, local governments contribute to administration and placing people in jobs (Beramendi 2012).

Grabka and Frick (2013) find that during the Great Recession of the late 2000s, employment and income levels remained stable in Germany, and that the flexible labor arrangements and the federal government's 'aggressive stimulus packages' proved to be beneficial, pointing out to the unitary elements of its federal structure and strong central steering mechanism. With the Hartz IV reform, which went into force in 2005, there was no increase in terms of the replacement rates for the first 26 weeks of unemployment. However, with this reform, the unemployed people would receive a flat-rate benefit after the first year of unemployment (Sjöberg et al. 2010). Unemployment and social benefits were merged into one administrative unit with these reforms. Why does this matter for the cooperative federalism of Germany? With this reform, it is argued that the competences of the *Länder* and the federal level were more clearly defined and a ‘protective’ relationship between the *Länder* and the municipalities were established. A direct assignment of tasks took place from the federal to the municipal level. With rising unemployment after 2005, and the fact that the expenses of the local municipalities actually increased despite the aims created burdens for the federal level. As Kropp and Behnke (2016) explain, Eastern *Länder had* unemployment receivers, but not receivers of welfare benefits, whereas the situation was the opposite in the West, and this had to be dealt with by changing the financial equalization system. As the authors explain, “*While responsibilities had been shifted to lower levels of government, this was not accompanied by correspondingly enlarged financial means, thus creating a problem of incongruity between different institutional layers*” (Kropp and Behnke 2016, p. 681).

6.5.3 How redistributive is the German welfare state?

Overall, one can argue that Germany’s federal system tries to equalize revenue based on needs. Therefore, as stated in the interviews, whether such growth inducing policies are actually disadvantageous in terms of receiving need-based benefits, and whether regions would rather opt-out of growing in order to receive the benefits - leading to a ‘race to the bottom’ - is a concern. There are also additional federal grants for the *Länder* that have less than 99.5 percent of the average financial capability, after the VAT distribution and the horizontal equalization scheme (Benz and Zimmer 2010). As stated earlier, the fourth stage of the financial equalization scheme consists of these federal (vertical) grants. General supplementary federal grants aim to decrease the gaps that remain after the other financial equalization instruments. These grants are highly progressive in the case of Germany. **Table 10** below shows the official results of the equalization system, as provided by the Federal Ministry of Finance. Also, as the OECD (2008) suggests, the redistributive impact of the German social policies is more limited than some other OECD states.

Table 10. Equalization of Differences after Financial Equalization and Grants in Germany

Financial capacity per inhabitant before the financial equalization among the *Länder* as a % of the average financial capacity per inhabitant	Financial capacity per inhabitant after financial equalization among the *Länder* as a % of the average financial capacity per inhabitant	Financial capacity per inhabitant after financial equalization among the *Länder* and the general supplementary federal grants as a % of the average financial capacity per inhabitant
97	91	97.5
80	93.5	98
90	96	98.5
100	100	
110	104	
120	106.5	
130	109	

Source: Taken from the table presented by German Federal Ministry of Finance, 2015

In Germany, in terms of GDP across *Länder*, one can easily see the divergence. However, after the equalization system, the poorer states are those with above-average expenditures, highlighting the highly redistributive aspect of its equalization in terms of regional convergence (Rodden 2010). Regardless of its federal structure, the redistributive component of the welfare state in Germany is not considered very high in Europe, in terms of interpersonal redistribution, despite the fact that it has a relatively progressive tax structure (Van den Bosch and Cantillon 2008). However, there are varying views on this issue. As one expert claimed in the interviews, "*The redistributive component of the welfare state (in German) is one of the lowest in Europe.*" Hauser (1999) explains that in spite of the disadvantageous conditions, the social security system in Germany attained its goals for the most part from 1973 to 1993 (quoted in Atkinson 2015, p.66).

For the period 1981 – 2000, Mahler et al. (2013) have studied the impact of taxes and transfers on inequality in 12 OECD countries. During this time, in Germany, taxes and transfers caused a reduction of 39 per cent inequality, indicating a medium level of income redistribution. This score was 20 per cent in the US and between 40 and 50 per cent in Scandinavian countries. Grabka and Frick (2013) argue that the plans of the government to reduce public spending on families with low income and a general cut in public expenditures after the Great Recession might have an inequality inducing effect in the medium and long term in the near future, which, arguably, could be playing a role in the current inequality increase in Germany. Also, one main argument is that the tax system became less progressive in the years 2000-2005, with the reforms brought by the Social Democrats and the Green Party, with reductions of the top marginal tax rate and other cuts in corporate and wealth taxes (Corneo et al. 2014). Overall, with an increase in the basic allowance within the personal income tax and child benefits, in the second part of the 1990s, the redistributive impact of the tax system was higher than it was in the 1980s and 2000s (Ibid 2014).

6.6 INTERACTIVE GOVERNANCE IN GERMANY: INTERGOVERNMENTAL RELATIONS, COORDINATION AND SOCIAL ACTORS

"*In contrast to most federal systems, German federalism was not conceived as an instrument and guarantor for territorial diversity, but rather dedicated to the delivery, through institutional* *cooperation, of common standards of public policy and services across the federal territory*" (Jeffery 2002).

As the author of the abovementioned quote would also agree, I classify Germany as a country ranking high in interactive governance, but what really makes it more interactive than another (*de facto*) federal country in the typology of this work, Spain? While the redistributive practices and the welfare state policies in Germany illuminate the link between the territorial governance/decentralization and inequalities, the argument of this dissertation goes beyond this link. As stated earlier, I argue that while decentralization is associated with higher inequalities, shared rule of the regions and more interactive of governance would help offset the inequality inducing territorial structure in a country, due to the coming together of various state and non-state actors toward similar goals through intergovernmental channels and platforms.

As in the other case studies, I first look at the intergovernmental aspect of interactive governance and then assess the role of social actors in policies that matter for inequality, especially pointing out to the institutionalized cooperation practices in Germany between different levels. Within this discussion, I also highlight the importance of vertical and horizontal coordination practices between different governmental levels and the importance of wage bargaining in the policy making process. I examine whether there are channels through which the central government interacts with the subnational units and the non-state actors in the formulation and the implementation of the main (social and fiscal) policies / issues that matter for inequality. How centralized or decentralized is wage coordination and what is the role of unions in issues related to inequality? As Börzel (2002) sums it up, "*the formal institutions of German federalism are embedded in an institutional culture which favors multilateral* *bargaining and consensus-seeking as the most appropriate behavior in territorial politics*". (p.41)

6.6.1 Interactive governance, intergovernmental relations and vertical and horizontal coordination in Germany

As one of the classifications of its federalism, Germany's "cooperative federalism" type has important bearings on discussions related to inequality. The division of labor and the assuming of tasks between the federal and Land level had already been established by the 1970s in Germany. As Jeffery (2002) argues, with the entry of SPD into government, the cooperation between the *Länder* and the federal level expanded to more policy areas, such as taxation, investment, health and education, and state interventionism also increased.

While the federal level is the main level for determining policy in Germany, the participation of *Länder,* and their co-decision powers within the *Bundesrat* have been the determining factor in understanding the intergovernmental relations, which would concern inequality. As Braun et al. (2003) argue, the *Bundesrat* can be considered as n institutional veto-point, "*if and only if laws have to be decided, which need the definitive approval of the Bundesrat.*" Especially in fiscal policies, which are our interest for this work, compulsory negotiations take place, and these are usually at the federal level.

Referring to West Germany before the reunification, Lehmbruch (1989) argued that the West German federalism was made of "*interlocking, but distinct and autonomous policy networks… Sectoral policy networks are integrated into overarching networks. The traditional pluri-centrism of state and societal institutions is contrasted with an integrated (but not* *centralized) economic policy network oriented toward national homogeneity*" (p. 221). Therefore, it is not necessarily that Germany is clearly centralized, but that it is integrated in a decentralized asymmetric structure, which is best dealt with centralizing moves. He goes on to say: "*However, homogeneity is not promoted by a strong centralizing force. Instead, political power and social influence are regionally dispersed*".

One interviewee claimed the following: "*In fiscal equalization, the non-state actors are active when it concerns taxes, but it is pretty much an insider game, meaning that 'politics 'actually shape the outcomes and even parties are not involved.*"[64] As another interviewee described, the general principle in Germany is that "*All the parties oppose and rule at the same time.*"[65] The same idea applies to the welfare policies as well. Bargaining is also conducted at the regional level but then the policies are implemented in a centralized manner throughout Germany. In the bargaining process, political parties link *Bundestag* and *Bundesrat* together. Also, *Länder* function as subnational units but their representatives are part of the federal party system, which again underscores the more interactive governance of the system.[66] The federal government requires a majority of the *Bundesrat* to pass legislation for matters that concern the *Länder*. However, it is also argued that the type of cooperative federalism also disempowers the regional legislatures, since the *Länder* competencies have been transferred to the federal level with the joint decision making process (Börzel 2002). When the Solidarity Pact was created in 1993, the interests of the *Länder* were utilized by the governing and opposition parties to

[64] Personal interview, Cologne, Germany, February 2014.
[65] Personal interview, Heinrich-Heine University of Dusseldorf, Germany, February 2014.
[66] The importance of party decentralization and party coalitions manifests itself in policy making. There are different coalitions at the *Bundestag* (CDU/CSU and SPD) and at the *Bundesrat* level. Currently, there are some a) *Länder* with Social Democrat coalition with Greens, b) *Länder* with coalition of Christian Democrats and Liberals (such as Sachsen).

overcome the partisan divisions in order to reach consensus on fiscal policy issues. Therefore, Braun et al. (2003) calls the *Bundesrat* "a *meeting place of the federal and the partisan arenas and may be used as institutional veto-point for both territorial and partisan* interests (p. 43). The fiscal intertwinement of the federal and the Bund level also manifests itself with the co-financing of joint tasks, which require high levels of public investments, such as infrastructure projects (Börzel 2002).

6.6.2 Horizontal and vertical coordination: the ministerial conferences and beyond

Germany's coordination between its subnational levels is considered to be higher than that of Spain, or other federal states such as Canada and the US (Biela et al. 2013). Bendel and Sturm (2010) argue that the "German politics is output oriented" since people care more about the results rather than knowing about the distribution of competences.

Germany's high level of interactive governance also stems from the existence of the intergovernmental conferences: *Ministerkonferenzen* and *Ministerpräsidentenkonferen*z are two types of intergovernmental meetings that are related to the functioning of federalism and policy outcomes in Germany. Again, relevant to the fiscal federalism of Germany, the Conference of the Finance Ministers of the *Länder* (*Länderfinanzministerkonferenz)* comprises the finance ministers of each *Land*, indicates horizontal interactions, and there are bureaucrats that accompany them in these meetings. Börzel (2002) explains this level as the *Gesamtsaat* (whole state) level where the Bund and the *Länder* are represented as equals. The main aim is to discuss budgetary issues and proposals of the federal government. Braun et al. (2003) deem this conference as the "most important coordination and concertation device between the *Länder*" (p. 43). Finance ministers also meet according to party affiliations.

Furthermore, the planning committees (*Planungsauschusse*) for different policy areas can be considered as a platform and a tool for coordination of different policies that are jointly planned and implemented by different levels. For a decision to be taken, the majority of the 16 *Länder* need to approve those decisions. Also there is a Mediation Committee where both chambers can negotiate ordinary legislation, which is opposite to the Spanish case. The 2006 constitutional reform also reflected the political bargaining culture of the regular Mediation Committee. Thus, the existence of these conferences and committees increase the interactive governance level in Germany, in terms of its intergovernmental aspect. Nevertheless, it is important to point out that a bi-cameral Commission in 2003 had failed to make consensus on constitutional reforms, before the ensuing 2006 federal reforms (Scharpf 2005). Therefore, reforming Germany's malfunctioning parts of the German federalism had not been an easy task.

In terms of coordination or devolution or the delegation of tasks from ministries to non-majoritarian semi-autonomous agencies, the German central government has not been reformed as radically as some other countries (Fleischer 2011; Pollitt and Bouckaert 2004). The German center of government has not been strengthened like many others, but steers executive politics by focusing on its institutionalized role as the hub of executive coordination (Fleischer 2011, p.71). In terms of an important attempt to exert influence over policies and stronger coordination, the office of the *Bundeskanzleramt* (Federal Chancellery) exists in Germany (Peters 2015).

The 2006 federal reforms did not bring major changes to the coordination practices in Germany and the German Chancellor remained as the chief negotiator and the relevance of *Bundesrat* increased over time, in the catch-all party versus smaller party – (now grand coalition) policy initiatives are developed incrementally to accommodate divergent interests. The steering role of the center has not changed, and the roles of different levels of have been more disentangled. As Fleischer (2011) spells it out:

"From a regulative perspective, governmental and administrative features put checks on the steering role of the center, multiactor constellation in executive federalism and coalition government, a powerful Constitutional Court, formal procedural requirements on executive politics and a cadre of political civil servants at the disposal of ministers" (p.70).

Germany's coordination between its subnational levels is considered to be higher than that of Spain, or other federal states such as Canada and the US (Biela et al. 2013). Bendel and Sturm (2010) argue that the "German politics is output oriented" since people care more about the results rather than knowing about the distribution of competences. Obviously, there can be cross-party politics leading to "antagonistic cooperation" at the federal level in Bundestag, overpowering the different types of cooperation. Therefore, in terms of the level of interactive governance, it is important to also underline the antagonism emerging out of the structure (Scharpf 1989; 2012). Still, Benz (2013) points out to the decentralization and nationwide coordination in compulsory intergovernmental negotiations among competitive actors (p. 76) and emphasizes the following about the German system:

1) Functional division of powers between centralized legislation and decentralized administration, joint decision making

2) Centralized and integrated political organization of society (Katzenstein 1987)

3) Actors representing political parties competing for votes at both levels of government (Lehmbruch 2000)

For this cooperative federalism structure, not to lead to "joint-decision trap", as Scharpf (1998) suggests, the *de facto* requirement of unanimous decisions at different levels need to be implemented with a problem solving decision making style. This obviously needs a strong steering mechanism and willingness by the federal government and *Länder*. West German political tradition – and current German politics - is not based on a majoritarian type of democracy; but instead made up of proportional representation, which usually produced coalitions requiring consensus and negotiation (Scharpf 1998). Therefore, not only the official federal constitutional structure, but also the electoral rules contributed to the joint-decision making style in Germany.

The participation of *Länder* in all the legislation, which requires their approval through the *Bundesrat*, can be traced to the "political culture of compromise which institutionalized into German federalism" (Hueglin 2013, p. 35). At the same time, the fact that the *Bundesrat* has veto power also inhibits federal reform if there are different political majorities in each house. As Benz (2016) concludes on the recent reform projects, the German federalism reform brought limited amendments to the system, separated the powers of the levels from one another, and no "meaningful" fiscal federal reform was made. Despite the fact Germany's institutional mechanisms work better in this regard than another (de facto) federal country such as Spain, the need for a good balance of unity and diversity ensues (Ibid 2016).

6.6.3 Example of intergovernmental relations: an affluent *Land*: the role of North Rhine-Westphalia in implementing EU policies concerning inequality[67]

The territorial governance structure in Germany has also been influenced to a large extent from the Europeanization process (Börzel 2002). North Rhine-Westphalia (NRW) is the most populous and fourth largest *Land* by size in Germany, with its capital in Dusseldorf and its largest city of Cologne. NRW is one of the oldest subnational units in Germany. In Germany, the *Länder* are in many cases older than the federal government. NRW was founded in 1946, whereas the federal government was founded in 1949. NRW was the heart of the coal and steel industry until the 1970s but then there was a transition to services and research and development. With the growth of the creative economy and the Internet and fashion industries, NRW thrived and currently about 95 percent of workers work in small and medium enterprises.

As explained earlier, negotiations about redistributive tax policies take place at the federal level with representation from both *Bund* and *Land* levels, but they are centrally coordinated. As a NRW official stated, "*Länder do not have the authority to propose tax legislation. The Bund level is very powerful in taxes and we need to influence that*". On the other hand, the European Union's (EU) policies that aim at poverty and inequality reducing mainly take place at the regional level and target regions. In this subsection, I draw from qualitative data gathered in NRW about the role of NRW and *Länder* in implementing EU policies general in policies that matter for inequality.

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[67] Information in this section is based on interviews with official representatives of North Rhein-Westphalia in *Düsseldorf* (*Land* level - *Staatskanzlei*) and Berlin (*Bund* level) and at Hans-Bockler-Stiftung, carried out in February 2014, and author's own elaboration of those interviews.

As a highly industrialized *Land*, NRW also has a high representative profile at the European Union level. In EU's operational programs, the 50 percent is co-financed by the member states, and the other 50 percent by the EU. As the official representative of NRW expressed: "*Between the three funds (Regional Development Fund, Agricultural Fund and European Social Fund), coordination is crucial to prevent overlap and cooperation is necessary with the EU to make sure that the relevant national actors implement the EU funds. Therefore, the coordination procedure, through which the subnational units and the federal government share power, is very important and NRW is successful in in managing this process. We also need to cooperate with the European Commission to make sure that the devolved priorities of the EU and its structural funds are carried out* ". This view is line with Börzel's (2002) explanation of the dilemma that the regions faced during the Europeanization process. They would either 'roll-back' because of losing some of their competences to the European level, or they would use this as an opportunity to "rein in" with their expertise, spending power and administrative capacity for applying the European policies, and Börzel (2002) argues that the latter prevailed, as my interviewees also stated.

As expressed by representatives of NRW in Berlin, in the dissemination and the implementation of the regional funds, the EU institutions pay more attention to the *Länder* whereby the *Länder* have the role of 'informal lobbying', for example at the Committee of Regions of the EU. The same applies to the *Land – Bund* relations as well. When the *Bundesrat* moved to Berlin in 2002, the NRW representation also followed suit and opened a representation in Berlin. This representation has an important role within the federal lawmaking process, especially in the *Bundesrat*. They have roles with different intensities concerning the '*Zustimmunggesetz*" (act of assent) whereby the *Länder* has the say in the *Bundesrat.* As explained also earlier, about 90 percent of the federal legislation goes to *Bundestag* (through mediation committees) and then to *Bundesrat*.

How is the “fight with inequality” carried out at the regional level? At the *Länder* level, the emphasis is on regional development and certain social programs. As of 1980s and with the Maastricht Treaty of 1993, the EU became more aware of the fact that the EU is made up of “regions”. As the official representative of NRW in Berlin stated: “*Smaller parts of NRW are more unequal. For example, Düsseldorf is rich, but the Ruhr Valley is poor, with the highest rate of unemployment. In this respect, the representatives of Länder, such as NRW, act as ‘informal lobbyists’ who are not formally a part of the decision making process. But we get in touch with Commissioners to talk about issues that interest the NRW, such as regional development. Therefore, we see formal and informal channels of representation converging for the same types of goals (pointing to more shared rule).”* As far as the European Social Fund is concerned, the new Eastern European members currently get a bigger share, so the share of older EU members, such as Germany, is decreasing. When these funds are allocated usually, the poorest regions and also issues that require ‘excellence’ which needs funding, such as universities, research and development get the funds from the EU. Also, issues of general politics, such as climate change and justice-police collaboration get funded and these are specifically issues pertaining to NRW, including electricity from coal and supply. Certain funds also go to research and programs regarding minimum wages and social inequality issues.

The NRW officials argue that the region has the capacity to implement projects with the EU Regional funds which all have to be co-financed at 25 percent, as expressed by the NRW officials. Related to the territorial governance structure however, not all the *Länder* have the experts and the trained personnel, in other words, the administrative capacity to implement the policies. The federal structure inevitably leads to certain disparities between the regions. As far as the budget is concerned, NRW has no more public debt and after 2020, there will be no more borrowing due to the new debt brake regulations put in place. About 20 percent of the budget is spent on interest rates and less than 30 percent is spent on staff. The rest goes to social security, defense, traffic and investments. Overall, the *Länder* spend around 50 percent of their budget on staff (teachers, police, courts). The budget of the '*Bund*' is quite flexible while at the *Länder* level, this is not so much the case. There are not substantial differences in salaries, not more than before – despite the civil servant pay reforms - , which means that the *Länder* cannot introduce or fight for great changes in that regard, again indicating an aim leaning towards equalization and standardization, and less competition. Still, some *Länder* are trying to compete with each other by attracting teachers to their region, as most public employees are mostly employed at the *Länder* level. This is an example of how a decentralized structure actually does not lead to 'race to the bottom' in terms of economic conditions but more a race towards attracting employees. However, this can also be linked back to the discussion of policy divergence and differentiation among the *Länder*, especially in terms of regional economic policy and other policy areas such as regional education policy. However, this is less pronounced in the case of Eastern *Länder*: There has been a collective request of federal financial support in areas such as education, health and regional economic development.

6.6.4 Social actors and interactive governance in Germany: wage bargaining and beyond

In order to test the significance of interactive governance on inequality, in addition to intergovernmental relations, the role of social actors is of utmost importance, according to the theory of the dissertation. To this end, I look at the changes in the influence of trade unions in wage bargaining and related matters, as well as the decentralization of wage bargaining in Germany. Wage bargaining institutions have explanatory power especially in terms of pay inequality (Beramendi and Rueda 2014). In general, information from the interviews suggested that trade unions have gradually lost influence in the recent years despite their achievements in the past. In this section, I will elaborate on their influence throughout the years on wage bargaining.

To understand the nature of wage bargaining in Germany and how it has contributed to interactive governance over the years, it is necessary to examine the evolution of the role of social actors in Germany from a qualitative perspective. Germany has had an autonomous collective bargaining legacy. Trade union coverage in Germany has historically been low, compared to Sweden, but higher than in France. The highest trade union coverage rate, which was in 1978, covered 35.5 percent of the employees, which is lower than Sweden, but higher than France. In the decade of 2000's, union density has gone down to about 20 percent (Visser 2015). The main trade union confederation is DGB, which is an umbrella organization, closely associated with the SPD (Iversen 1999). Bargaining usually takes place at the industry level with the coordination of all the regions.

It is argued that trade unions had a strong voice in the reforms of 2004, and unions mobilized against the government. Collective bargaining has become more decentralized in Germany in the recent years (Ochel 2005), which has contributed to differentiation in pay levels, shown as one of the reasons of rising inequality. With more deregulations after the reunification, and with the Hartz reforms of the 2000s, the unemployment benefits were reduced and the requirements of unemployment insurance were changed. Restrictions on fixed-term contracts were lifted, which were unpopular with the social democratic leaning voters (Hemerijck 2013). As a result of these reforms, more people started to have "atypical" jobs without full contracts, expressed as a possible reason of increasing inequality. This led to a decrease in the percentage of coverage of people under collective agreement, with only 61 percent in 2010 as opposed to 85 percent before the reunification (Bosch 2015). With more flexibilities in wage-setting and more concession-bargaining put into place, memberships in employers' organizations and union density also increased; shown as a reason why wages did not increase so much in Germany before the financial crisis (Hemerijck 2013). Yet, the traces of the autonomous collective bargaining system also paved to way for the establishment of industry-wide minimum wages in 2007, and then a national minimum wage put into place in 2015, creating a hybrid system of autonomous and state intervention system (Bosch 2015). Also, as stated earlier, with the unification, the collective bargaining scheme of Germany was changed mainly with a view to fiscal consolidation (Streeck 2015).

In the database of Visser (2015), Germany's wage coordination classification has oscillated from 4 to 3 and vice versa, in the period of 1960 – 2014. A score of 4 indicates that wage norms or guidelines are based on: a) centralized bargaining by peak associations with or without government involvement, b) informal centralization of industry-level bargaining by a powerful and monopolistic union confederation c) extensive, regularized pattern setting coupled with high degree of union concentration. A score of 3 indicates that negotiation guidelines are based on: a) centralized bargaining by peak associations with or without government involvement, b) informal centralization of industry-level bargaining, c) government arbitration or intervention. There was a macro-level coordination process in Germany, between 1967 and 1977, which failed (Iversen 1999). After 1978, the only years the score was 3 instead of a 4 were

1998 – 2001. Therefore, Germany still is classified among the more centralized bargaining countries, on a scale of 0 to 5.The table below displays the **processes** and **outputs** related to interactive governance in Spain, inspired by the conceptualization in Torfing et al. (2012).

Table 11. Interactive Governance Index of Germany

hnProcesses	0 Low	1 Medium	2 High
Identifiable goals – concerning equality in tax capacities and social policy delivery			X Commitment of the political culture to 'egalitarianism'
Vertical: Clear and observed rules of relationships between each subnational government and the central government			X
Vertical interactions (mutual contingencies and interdependencies between different levels)			X
Relying on social partners and compromise		X	
Harmonized and integrated policies at various levels		X Reforms changing the competences of levels – but without drastic changes	
Outputs **Goal attainment and distributional effects**			
Institutionalization and dissemination of revenue collection with equalizing effects			X
Systemic approaches to governing at different levels			X

6.6.5 Summing it up: the case of Germany

As the literature shows, federalism makes a country prone to political, administrative and economic diversity. At the same time the processes that lead to diversity vary across cases. The quantitative chapter and the German case study demonstrate that the territorial governance structure is significantly associated with national and regional income inequality. Germany is one of the major OECD economies with rising inequality, especially after its unification. However, despite its changes in the labor market structure that fueled inequality, it still retains its position as a "low to mid-level inequality" country in the OECD, mainly as a result of its redistributive federal policies and more egalitarian fiscal policies. Since the competences of the subnational units, and the relationships between the subnational levels and the federal government have not changed to the extent they will impact the overall welfare state and redistribution levels, we cannot yet attribute the changes in the *Gini* scores to federal reforms with certainty. The implementation of some parts of the reforms, which are yet to be seen, will shed more light on this issue for future research. Yet, interviews corroborate the literature that official intergovernmental mechanisms set in the federal structure of Germany for vertical and horizontal coordination among the regions are effective in sustaining the welfare state and achieving consensus despite contentions among the *Länder*, in a context challenged by the unification, and then to some extent, the economic recession. Furthermore, the *Länder* have important – but asymmetric according to their needs and capabilities – roles in terms of administering EU's regional policies. "Federal entanglement" was supported by all *Länder* during the federal reforms (Kropp and Behnke 2016). Therefore, evidence points in the direction of a centripetal Germany, whereby the 'culture' and the 'laws' are in place, with – at least – the aim of achieving interpersonal standardization of welfare services which would have an impact on reducing or at least sustaining mid-level overall inequality levels in Europe. However, the disentanglement of different levels in the federalism reforms has not shown a clear direction, in order to assess them directly. Studies have shown that taxes and transfers reduce inequality at about 39 percent – medium level of reduction - in Germany (Mahler et al. 2013). The unequal aspect of the federal structure has more implications for increasing inequality among the *Länder* rather than among persons – as opposed to Spain - , while the centrally decided redistribution system achieves its roles of achieving standardization to a considerable extent.

Even though the *Länder* do not have the autonomy at their own level to decide on fiscal rules that would matter for inequality, intergovernmental relations are of more interactive nature, especially with regards to the representation of *Länder* at the federal level through the *Bundesrat*. Furthermore, the fiscal federalism reforms, which will be fully in effect as of 2019, have created a "stability council" which will be made up of the federal finance minister, the federal economy minister and the *Länder* finance ministers. While inequality has been on the increase after 2013, despite a decrease after 2010, this can pave the way for a possible increase in the cooperation between different levels towards similar financial goals throughout the country (Feld and Baskaran 2009). Despite fiscal policies being centrally determined, the fact that the federal government shows a commitment to unity also bolsters the shared-rule component of federalism. As Börzel (2002) stated, "*the formal institutions of German federalism are embedded in an institutional culture which favors multilateral bargaining and consensus-seeking as the most appropriate behavior in territorial politics*" (p.49). Bicameralism is another institutional tool to achieve this inter-regional distribution, highlighting more commitment by the state to this end (Bordignon 2010). With this bicameralism, the shared-rule part of regional authority is more accentuated.

Overall, applying the theory of the dissertation to the German case, one can see that increases in shared rule, especially in terms of fiscal control and borrowing control are more visible, rather than increases in self-rule. The reforms concerning changing the power of the

Bundesrat are also examples in this vein. However, extant work and interviews show that variables that have impacted increasing inequality in Germany have not necessarily been affected by the changes in the sharing of competences significantly. Along with changes in the labor market, unemployment and tax policies are associated with rising inequalities according to some studies. However, they do not exhibit a strong pattern or trend that is associated with more centralization/decentralization. Nevertheless, we can argue that increases in shared rule might have an inequality reducing effect in the long run. Germany, being a federal and a decentralized country, is classified as a low-middle inequality country, despite its increases after the 2000s, and its high interactive governance – with intergovernmental features, as well as relatively more centralized bargaining – has contributed to Germany's remaining in this inequality category. Its strong central steering and its interlocking politics are important features that impact Germany's inequality more from a static, rather than a dynamic perspective.

7.0 FRANCE: A UNITARY COUNTRY WITH DECENTRALIZED FEATURES AND LOW INTERACTIVE GOVERNANCE

"*Center-periphery problems start from the center; that is, the center (if it is a center in any meaningful way) has control over the periphery... There are only three general modes of exercising central control over the periphery – whether we are considering the center of a family, or of a nation, or of an international coalition. One, historically a very important one, is to ignore the periphery. Pay no attention to it. Pretend it does not exist and give it no particular concern. This mode of handling I call Disinterest. An obvious example of disinterest is Marie Antoinette's imperious "Let them eat cake!" This is a marvelous center-periphery relationship illustrating disinterest. For the French court at that time the periphery began at the court gates. Anybody who really belonged to the center had a pass and could get in; people who could not get in did not belong to the center. They were peripheral in the literal sense of "external boundary*" (Lerner 1968) (p.259).

France is a country with a long-standing tradition of an emphasis on its 'center' and a big distinction between its center and its peripheral regions. Building on the legacy of the past explained in the quote above, France is in the 'unitary and low interactive' category of this dissertation. This chapter will explain why I consider it as non-interactive and how it exemplifies the unitary state with strong central features, which has undergone a significant process of *devolution* and *decentralization*. At the same time, some recent reforms have had more recentralizing tendencies, maintaining the strong hold of the center.

The process of decentralization, with the most recent wave ongoing since the early 1980s, has had important repercussions on the sharing of competences between different levels of government in France. As in other cases, these repercussions have significantly impacted *fiscal* and certain *social policies*– the dimensions of the welfare state - that have a significant bearing on inequality, as well as intergovernmental relations. Furthermore, the influence of social actors in policy making and intergovernmental relations are also related to decentralization, which in turn affects the interactive governance level in France. France is in the *'low-interactive'* category of the dissertation, but is it also moving towards more interaction and can it be considered a medium interactive governance state? Do these changes significantly correlate with changes in inequality levels? The official motto of the French state is "liberty, equality and fraternity": With an ongoing process that has altered the territorial governance structure, to what extent does France achieve its equality principles, at least in terms of income distribution? To test the theory of this dissertation on the French case, this chapter analyzes the extent to which decentralization and interactive governance – as defined earlier - in France is significantly associated with income inequality.

In order to link the independent variables (decentralization and interactive governance) with the dependent variable (income inequality), to test how the theory applies to the French case, the chapter proceeds as follows: 1) how France is a constitutionally unitary country with decentralized features, 2) the *decentralization* processes (and some recentralizing and reorganizing reforms that accompanied these processes), 3) an overview of the evolution of the welfare state of France, 4) recent inequality trends in France, how the territorial governance structure has impacted the creation and implementation of *fiscal* and *social* policies that matter for inequality, 5) what features make France a non-interactive governance country looking at intergovernmental relations, coordination mechanisms and the roles of social actors and what does this mean for inequality? In this chapter, I make use of findings from elite interviews, inequality data from OECD and Standardized World Income Inequality Database, as well as primary sources - such as Senate discussions and press releases - and secondary sources[68].

7.1 THE CONSTITUTIONAL STRUCTURE IN FRANCE: THE ARRANGEMENT OF THE GOVERNMENTAL LEVELS AND SUBNATIONAL AUTHORITIES

"Equality - inequality is a fiscal debate that requires a close look at the local and regional authorities."[69]

In the typology of Lijphart (2012) and Biela et al. (2013), France is classified as unitary and centralized. In 1958, the Fifth French Republic came into existence with the proclamation of the Constitution, which is currently in effect. France is considered a semi-presidential, or a "dual" system, whereby there is a government with a Prime Minister that is accountable to the parliament, as well as a strong executive President (Cole 2012; Elgie 2013).

France operates on a '*mille-feuille territorial*' structure of four different levels with overlapping competencies, which indicates that there is no official hierarchy among the different tiers (Cole and Pasquier 2013).[70] According to the current 1958 Constitution, Title XII, Article 72:

"The territorial communities of the Republic shall be the Communes, the Departments, the Regions, the Special-Status communities and the Overseas Territorial communities (to which article 74 applies)… No territorial community may exercise authority over another. However,

[68] Qualitative data from interviews conducted in March 2014 in Paris and Rennes, France.
[69] Personal interview, Rennes, France, March 2014.
[70] This has been altered to a certain extent with the 2010 Territorial Reform Act. This overlap is an important feature of France, which I will revisit later to assess the low interactive nature of the governance.

where the exercising of a power requires the combined action of several territorial communities, one of those communities or one of their associations may be authorized by statute to organize such combined action". Therefore, "shared competences" is the norm in France (European Union Committee of Regions).

It is important to note that there is no "*definitive list of local authorities*" according to the 1958 Constitution.[71] There are two chambers operating at the central level, the lower being the National Assembly, and the upper chamber being the Senate. Cole (2012) argues that the Senate "*is an archaic (yet occasionally effective) institution, overrepresenting rural and small-town France at the expense of the urban areas of the population*", which indicates that the Senate does not have the key role of territorial representation like the *Bundesrat* in Germany (p. 310). The Senate is made up of 348 senators who are elected by a college of 150,000 elected officials (*grandes electeurs).*[72] Nevertheless, Article 24 of the French Constitution states that, "*The Senate, whose members must not exceed three hundred and forty-eight, shall be elected by indirect suffrage. The Senate shall ensure the representation of the territorial communities of the Republic*."[73]

It is important to note the French revolution of 1789-94 as a defining period for the establishment of the French nation state and its strength of the 'center' (Cole 2012). In France,

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[71] Ministry of Interior, Local Authorities. Furthermore, Corsica has a special autonomous region status since 1982 (Hooghe et al. 2010). The overseas departments and regions of Guadeloupe, Guyana, Martinique, Reunion and Mayotte are governed by the Article 73 of the Constitution, whereas the overseas communities of Saint Pierre and Miquelon, the Walis and Futune Islands, French Polynesia, Saint-Barthelemy and Saint-Martin are governed by Article 74 of the Constitution, taking into account their different interests.
[72] This electoral college consists of "*members of the National Assembly for the department and members of the department General Council as well as the more extensively sited Regional Council*" and delegates from some municipal councils. Delegates from municipal councils constitute 95 percent of the members of the electoral colleges.
[73] I will revisit the role of the Senate when talking about the low interactive nature of governance in France.

the power of the central state and the concentration of the resources of the state in the capital city, Paris, are considered as legacies of the Revolution: Lerner (1968) states:

"*The French Revolution produced the remarkable phenomenon of Paris… Revolutionary displacement often is a wasteful process… it forces the allocation of human resources to the creation of a new center. For example, Paris historically has drained all France of skilled human resources – the best minds, the most ambitions; the most energetic come to Paris. This results from the influence of an overly powerful center on its periphery*" (p.263).

Cole (2012) notes that the parliamentary regime, the traditions of revolutions, and strong centralized institutions - which are legacies of the Napoleonic tradition - make France a "*curious synthesis*" (p. 308). This case study aims to shed more light on this "*curious synthesis*" to explain how centralization and decentralization processes occur at the same time in France- a country which, at first, arguably seems as one of the most centralized countries in the world.

At the same time, France, as we know today, has always been a space of cultural diversity with distinct peoples such as Bretons, Basques and Normans among others. Knapp and Wright (2001) explain how centralization worked to create a strong regime:

"Like the monarchs of the ancient regime, they (Jacobins of the First Republic) imposed centralization as their means of strengthening the regime against both internal opponents and external enemies. Napoleon perfected and future regimes consolidated the centralizing work of Jacobins. Each was uneasily aware not only of its own fragility but also of the very precariousness of the French national fabric" (p. 340).

Having a powerful center not only had led to a consolidation of power in that center, but also to the increase of central influence on other regions and subnational levels. Hayward (1983) argues that the task of the local governments in France has historically been the integration and contribution of the peripheral regions to this centralized system. This is also because the local notables represented the interests of the local population whose aims were to obtain the central state resources after providing intelligence (Cole 2012). Resources for development were provided by the central state.

Before explaining the devolution and the decentralization processes, below I present a brief look at the different territorial layers in France and their competences. While France is not a federal country, it is nevertheless crucial to understand the sharing of competences and the distribution of power between these layers. Their jurisdictions usually overlap, which creates complications in terms of welfare state policy creation, funding and implementation, with possible implications for inequality. As Cole (2012) expresses: "*In practice, the various subnational authorities have overlapping territorial jurisdictions and loosely defined spheres of competence. Even when responsibilities are clear, they are not always respected.*" (p. 312). Cole (2012, p. 120) argues that this complexity of the system actually renders teasing out the competencies of different layers somewhat obsolete, requiring network analyses to illuminate the actual intergovernmental power sharing: "*French sub-national governance rests upon a complex actor system, whereby policy is managed by plural actors with overlapping responsibilities at several levels. Complex actor systems produce interdependent relationships, rather than clear-cut transfers of responsibilities*" (p. 120).

7.1.1 The center: the main steering wheel

The central state is considered the bastion of maintaining 'overall equity' in the country whose local authorities have undergone many changes. As Cole and Pasquier (2013) argue, "*whether led by governments under Gaullist, socialist or UMP control, the central state has been closely involved in local government reorganization in the name of broader principles of territorial* *equity and economic efficiency*" (p.77). While the decentralization process has been taking place in the recent decades, the central state has had the role of **steering** the intergovernmental relations on issues related to inequality. Therefore the concept of "steering from the center" is very relevant to the French case (Hayward and Wright 2002; Cole 2011; Dahlström et al. 2011; Bezes and Le Lidec 2011), as will be reiterated again in the next sections of this chapter. Cole (2012) states that the government is "*state-centric*", "*executive-focused, and prone to zero-sum decision making*" (p.309). However, since the mid-1980s, the central state has also facilitated the creation of 'single task agencies' and sector-specific agreements, e.g. in urban affairs, to facilitate decentralization for a less interventionist type of state steering (Hayward 1983; Cole and Pasquier 2013).

Centralization, according to Knapp and Wright (2001) has had a political and economic basis to it, which they explain in five different dimensions:

1- "The obsessive control exercised by Paris and the provincial agents, such as its prefects and the technical field services,
2- Archaic nature of local government structures,
3- Conservative nature of the local elites
4- Local governments' **dependence on the center for financial resources**: "A *senatorial report of 1973 enumerated no fewer than 150 kinds of subsidy available to local authorities, channeled through 17 different agencies. Mastery of such **complex procedures** combined with the competing needs of local authorities afforded the State great financial leverage*" (p.350).
5- Centralization of most political, economic and financial actors complemented the centralization of the state."

7.1.2 Regional councils (regions): the overlooked level of the French system

In France, the concept of a region and its tasks take a somewhat different meaning than countries such as Spain or Germany, mainly because regions are artificially created tiers that have not been considered a strong part of the political system. This is partly because they have not had the "organizational heritage" or the "political or bureaucratic resources" that the departmental councils possessed (Cole 2012). The fact that the competences of the regions are limited to a large extent contributes to the general weakness of the subnational levels in France. A factor that has contributed to the non-interactive nature of the French governance is that regions have been politically, fiscally and administratively weak compared to the central state or other subnational levels.

However, it would be inaccurate to consider the regions as subnational units with no clear competencies or functions. While today's French regions were initially created in the mid 20th century as "technocratic outposts of the state" (Cole 2012) to contribute to development, transportation and planning, they did not gain significant powers until 1980s and onwards (Levy 2001). They did not have a big budget nor could they hire their own staff (Levy 2001). Nevertheless, we can still trace the origins of the regions to earlier times. In 1919, during the Third Republic, seventeen economic groupings were created in France, which can be regarded as predecessors of the regions as we know today. In 1941, the Vichy government appointed eighteen regional prefects as representatives of the central government in enforcement.[74] The regional prefects were created in 1959, to "give cohesion" to economic planning and to coordinate the prefects of the departments. One interviewed expert explained the reasoning of the development of the regions as follows:

"(Interwar) regional planning policies were systemized after World War II for mobilization, state modernization and to create a space for governance. It was a regional

[74] "La decentralization", http://www.collectivites-locales.gouv.fr/decentralisation

configuration, and they tried to develop territories through public policies such as cultural or environmental policies."[75]

The decentralization process that led to the regions did not come about easily, since the Gaullist referendum of 1969 failed, and pseudo-regions were created in 1972 that paved the way for regional elites (Le Gales 2006). As of 1982, there are 22 regional councils, titled '*collectivites territoriales'*[76] in France. When they were first founded, they were not envisaged as entities with historical legacies or regional identity, except for Brittany, Alsace and Corsica (Balme 1999; Cole and Pasquier 2013). One of the experts expressed the following point on regions:

"*The identity dimensions of regions lead to diversity in France. In Brittany, which is considered a region with a historical identity, there was fiscal autonomy, and can be considered very similar to certain Spanish regions, such as Galicia, Catalonia and the Basque Country, or Wales in the UK*"[77].

Being directly elected and official local authorities since 1986 as a result of the reforms of 1980s has given the regional councils a stronger mandate than before, and they indeed have competencies in implementing training, transport or secondary education policies (Marcou 2008; Cole 2012). Pasquier and Cole (2013) explain the difficulty of distinguishing the competencies of the regional councils: "*Their competencies are rarely exercised as stand-alone services*". Again, the overlap of competencies emerges as an important feature of the territorial governance

[75] Personal interview, Rennes, France, March 2014.
[76] The number of regions will be reduced from 22 to 13 in 2016 following the new law on the organization of the territories in France. I will reiterate point in the subsection of decentralization reforms. The current 22 regions are Alsace, Aquitane, Auvergne, Brittany, Burgundy, Centre-Val de Loire, Champagne-Ardenne, Franche-Comte, Île-de-France, Languedoc-Roussillon, Limousin, Lorraine, Lower Normandy, Midi-Pyrenees, Nord-Pas-de-Calais, Pays de la Loire, Picardy, Poitou-Charentes, Provence-Alpes-Cote d'Azur – Rhone-Alpes, Upper Normandy. The region of Corsica also has a territorial collectivity status. There are five overseas regions.
[77] Personal interview, Rennes, France, March 2014.

structure in France. Hooghe et al. (2010) argue that "*as with departments, central state de-concentration lingered alongside regional authority. The post of regional prefect was reduced, rather than abolished, thus creating a two-headed regional executive*" (p. 80). In the words of an interviewed expert "[In France] *regional policies are [also] viewed through national logic, and departments (as subnational units) are stronger than the regions*."[78] This "national logic" summarizes the general sentiment towards subnational policies in France, which has contributed to the idea of the uniformity of resources throughout the country.

As Cole (2012) describes, "*French regionalization was intended to produce more effective decision-making, not to give rise to what Jacobin opponents call 'communautarian' or regionalist identities*" (p. 317). They cannot be regarded as the equivalent of *Länder* in Germany (also in terms of fiscal powers), and partly due to this, "*metaphors of multilevel governance have more resonance in the German case than French*" (Cole 2012). Highlighting the lack of authority of regions over other subnational units, Pasquier (2003) argues: "*Regional authorities are in no position, thus, simply to impose their will on "lower" units: they must negotiate and convince*".

Before the recent decentralization reforms of 2003-04, regions were regarded as the weakest subnational level among the subnational authorities. In Levy's (2001) words, regional authorities suffered from a combination of "*administrative, fiscal and political handicaps*". The next subsection will detail the changing competences of the regions in the decentralization process. The region of *Île-de-France*, with its center in Paris, can be considered as the center of

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[78] Personal interview, Paris, France, March 2014.

France, but it does not have its own separate identity as a region. As an expert explained in an interview:

"*In other parts of Europe, such as Belgium, Spain, Italy or the United Kingdom, regions which contribute a lot to the national growth are also those that are interested in further autonomy - such as Catalonia - , also due to the fact that identity politics play an important. However, in France, the central region, Île-de-France has no separate identity. It attracts young people, for example those who want to come to study at the university. There is a push and pull factor. Where there is richness – like Île-de-France, there is no drive for political decentralization. This is a centralized system, based on mobility and leaving Paris after [university].*"[79]

One interviewed expert pointed out to the strength of the central region: "*Île-de-France has 18 percent of the population and 30 percent of the national growth*". The fact that such a large percentage of the population as well as the country's economic growth are concentrated at the center of country indicates disproportionality in terms of the distribution of these elements. "*Île-de-France region is dynamic, getting younger and producing the highest level of wealth and inequalities. It is the filtering pump attracting the most qualified labor force and firms in dynamic sectors…*" (Le Gales 2006, p. 207).

[79] Personal interview, Rennes, France, March 2014.

7.1.3 Departments (*départements)*

Departments of France can be regarded as the legacy of Napoleon. Under the ancient regime, regions had some autonomy but these were replaced with departments, which were named after rivers, with new prefects heading them (Ardagh 2000). Originally created in 1789, currently there are 96 departments (*départements)* in France. After the French Revolution, the newly established departments replaced the former provinces (Bezes and Le Lidec 2011). They hold competencies such as environment, regional planning, education, environment and health, thus there is an overlap of competencies of the departments especially with the regions. The big network of field services of the central government (local agencies) expanded with the prefects, founded during the time of Napoleon, who were the mediators representing the central government in the departments and working as mediators between different levels (Cole 2012). From the last decades of the 19th century until the end of 1970s, the most important local services, such as culture, roads and infrastructure at the departments were provided by the central government. Municipalities did not have capacities to undertake these public works.

Until the 1982 decentralization law, prefects, who were the central state appointed officials, headed the *departments*. After the 1982 reforms, the powers of the prefects were transferred to department council presidents, who were directly elected. In 1997, the revenues of the subnational levels, meaning the municipalities, departments and regions combined, amounted to only 10 percent of the public revenues. This amount was 30 percent in Germany (Levy 2001). Departments have seats in the Senate according to their populations and they do not have any fiscal control, meaning that they are not represented as separate territorial units at the national chambers to make fiscal decisions together with the government (Hooghe et al. 2010).

Nevertheless, departments are important layers in terms of welfare state provision, in social policies such as intermediate education, social services, and minimal income provision - *revenu de solidarité active* – (RSA).[80] RSA became the responsibility of the departments without them asking for it in the first place (Cole and Pasquier 2013).

In terms of the *self-rule* component of subnational regions, Hooghe et al. (2010) consider the French regions and departments as "**dual executive**" subnational units because "*the central government appoints (or has appointed) a prefect or governor alongside a regionally appointed executive*" (p.21).

7.1.4 The local municipalities: the communes and intercommunal public corporations

France has more than 36,000 communes, which elect around 550,000 local councilors, making it the country with the largest number of communes in Europe. As Cole and Pasquier (2013) describe, "*The commune is a symbol of civic identification*", and the layer above communes, which are cantons, remain more artificial. This is also because communes are one of the oldest creations of France, created in 1789 (Local Authorities of France 2017). Communes as we know them today are traceable to the 11th-12th century ecclesiastical parishes (Cole 2012). The capital city Paris counts as both a department and a commune. In addition to issues like water, transport, energy distribution, social housing and policing, key responsibilities of communes include urban planning and territorial development and support for economic development to the regions, which make them counterparts in regional development (Marcou 2008).

[80] I will elaborate on the lack of fiscal control and RSA in the third section where I talk about the fiscal and social policies related to the territorial governance structure.

While citizens are loyal to their communes in France, it does not mean that the loyalty translates into their co-decision making powers with the central state, or their governance capacity. They mainly deal with “matters of immediate proximity” (Cole and Pasquier 2013). Compared to countries such as Sweden, the power of the local governments remains limited in France. In addition to the regions, departments and the communes, “*intercommunal public corporations*” (EPCI) are also considered as the significant local authorities, which supplement the communes for dealing with matters of “immediate proximity”, such as low-level social assistance and municipal services (Cole and Pasquier 2013; Cole 2013). EPCI are public establishments for cooperation between towns for joint development projects and they have some powers to raise taxes as well. One criticism of EPCI is that indirectly elected executives have considerable power, which does not allow them to be fully scrutinized in a democratic sense. As of January 1, 2016, there are 2062 public inter-municipal cooperation bodies (EPCI) with their own tax on French territory (Local Authorities of France 2017). They have the function of carrying out certain “inter-communal” services such as waste disposal, economic development, fire fighting and housing issues (Cole and Pasquier 2013). One can argue that the EPCIs will be a locus of interaction, which might increase interactive governance in France in the near future. I will return to EPCIs in the section on interactive governance in this chapter.

7.1.5 *Métropoles*: creation of a new subnational level

France is in the process of creating 10 metropolitan areas, called “*métropoles*” as part of the ‘decentralizing reforms’ in order to streamline the ‘territorial architecture of France’, with the Law promulgated on January 27, 2014. With this law, a special status was granted to Paris, Lyon and Marseilles, the three biggest cities in France, and the status of *métropole* was granted to Bordeaux, Grenoble, Lille, Nantes, Nice, Rennes, Rouen, Strasbourg and Toulouse (Cole 2012). The French government explains the necessity of the creation of these metropolitan areas as follows:

"In 30 years, France gained 10 million people and the old boundaries between town and country tend to fade more and more, three quarters of the population concentrated on 20 percent of the territory. The current reform of the territorial organization deals with all these issues. The territorial reform intends to transform decades of territorial architecture of the Republic. At stake: The decrease in public spending and a better consideration of the citizens' needs."[81] How this new endeavor will impact redistributive practices in the *mille-feuill*e structure of France will have to be assessed in the near future, especially whether it will result in the granting of more power to these territorial units, and how it can alter the distribution of power among different layers. Nevertheless, it is an important example of the ongoing reorganizational practices of territorial governance in France.

7.2 THE DECENTRALIZATION PROCESS IN FRANCE AND ITS IMPACT ON INEQUALITY RELATED ISSUES

The necessity of creating a welfare state was one of the reasons why France became the centralized country it is now, building on its revolutionary legacy. At the same time, the

[81] French Government Official Website, Translation from the French website. These ten new metropoles are: Rennes, Bordeaux, Toulouse, Nantes, Brest, Lille, Rouen, Grenoble, Strasbourg and Montpellier.

centralization of the 20th century occurred in a setting that was heavily localized, which was only to be decentralized even further. Concerning this process going in both directions, an expert stated in an interview: “France has seen an increase in its centralization after the two world words because of the development of the welfare state. This also led to the fragmentation of municipalities. The network of the field services of the central government and the representation of the central government was conducted through the mediators of the central government and this also helped the departments.” Therefore we see that the duplication of tasks was added to the centralized feature of France, while reinforcing decentralized elements at the same time. Hayward and Wright (2002) call this French context “a fractured indivisible republic”. In France cooptation between state and local agencies also played a role in the decentralization process (Thoenig 2005; Grémion 1976).

The communes had been in existence in France long before it became a centralized nation state, indicating the decentralized origins of the state. On this topic, an interviewee stated: “*Before the First World War, the half of public expenses were met by the local governments. The overall level was lower than now, but nevertheless the country was not so centralized. After the First and the Second World Wars, the centralization process increased. The fragmentation of the municipalities was an outcome, since they couldn’t handle it [the expenditures]*.”

The latest wave of the political and administrative decentralization has been ongoing in France, since the 1960s. Regionalist movements in regions like Brittany, Corsica and Languedoc-Roussillon have promoted language and cultural interests, which have since developed as the overall decentralization process has progressed in France. The process of decentralization in France started with the advancement of parliamentarism, with the aim to give more power to people with properties and so that they could pay a lower level of taxes. The administrative decentralization paved the way for political decentralization: First, France undertook the process of de-concentration (territorial administrative decentralization) starting in 1964, so that the central state built up its capabilities for regional economic planning (Pontier 2010; Cole 2011).

Unlike Spain, where there is disagreement over the categorization of the country as unitary or de facto federal, France's unitary constitutional structure leaves no room for debate. The idea of administrative uniformity throughout all the territories has been one of the defining features of France (Cole 2006). Jacobin governments created the centralized French government structure with the departments and communes, which were headed by the prefect – a central government official, until 1982. These prefects had the task of administering the departmental councils (*conseils generaux*) as well as supervising the communes. This was the main mechanism through which the central state actually exerted its influence over the periphery. One of the most important changes brought about by the 1982 decentralization reforms was that prefects were no longer the executives of the regions and departments, giving more autonomy to these subnational levels (Levy 2001).

Several authors have written about the diversity of the public services that resulted from decentralization (Bernier 1991; Schmidt 1990), which has led to an increase of investment in infrastructure, such as schools, roads, houses. Levy (2001) explains the problems of decentralization as follows: "regional weakness and sub-national rivalries, obsession with luring mobile investors and insular, elitist policy making… sub-national authorities have used their new freedoms to enhance the diversity and quality of public services… France's regions, departments and municipalities have unleashed a flurry of politic initiatives".

The 'Jacobin' ideal of the nation state has gone through series of transformations in the recent decades, mainly attributed to the regionalization created through Europeanization and the autonomy demands of the subnational structures (Cole and Pasquier 2013). As Thoenig (2005) explains, the "quasi-ideal" unitary French state, as referred to by de Tocqueville (1856), was challenged when Mitterand surprisingly introduced the decentralization reforms in the early 1980s. The decentralization laws of 1982 -3, and then the decentralization reforms of 2003-04, have significantly altered the territorial governance of France, and manifested mainly political and administrative types of decentralization, rather than fiscal. Cole (2012) elaborates on the aims of the two decentralization processes until 2004 as follows: "Both processes reasoned at an early stage in terms of territorial differentiation and experimentation, but neither pushed this analysis to its logical conclusion. Both played with the idea of territorial leadership by recognizing lead authorities, but stopped short of following the quasi-federal logic of allowing the regions a general authority over the other layers of local government" (Cole 2012, p.122).

This latest wave of the decentralization process started with the 'Law on the Rights and Liberties for Communes, Departments and Regions' in 1982, which brought several important changes to the territorial governance structure in France, pioneered by Gaston Deferre, the Interior Minister during the Mitterand Presidency, who was also behind the decolonization law of France (Levy 2001). There were two features of the 1982-83 reforms that actually contradicted each other: Matters of immediate proximity, including low-level social assistance became the competences of the communes and inter-communal bodies, but at the same time all levels could initiate policies they deemed important for their constituents. It is also argued that these reforms are among the few remaining 'structural reforms' of Mitterand years in France (Levy 2001; Hall 1986). According to this understanding of 'blocs de competences', the departments would deliver welfare related policies such as higher social assistance and minimum income help. Strategic issues, such as infrastructure, development, and some of the secondary education, would be under the realm of regions (Cole 2012). Thus, the process of further decentralization could also be regarded as paving the way for more centralized policies as well. With this Deferre law, state functions were transferred to local units, while regions were also “elevated into local authorities” with lessening state controls on the executive (Cassese 2003). Following this, the reforms in 1992 ascertained that central administrations can give guidance to local authorities, but state field offices have the main responsibility, and this enhanced the powers of the regional prefect (Ibid 2003).

The decentralization process in France can be divided into two parts with different tendencies. As Bezes and Le Lidec (2011) explain, “…one has to distinguish two phases of decentralization, each of which had different effects on steering. The first wave in the early 1980s strongly challenged the historical and hierarchical mode of governance and resulted in the fragmentation of public policies and the weakening of the center. By contrast, the second reform of the early 2000s came with simultaneous efforts to reshape the administrative state and reinforce its steering capacities” (p. 31-32). Therefore the centralizing tendencies actually aimed at enabling the center with a stronger steering capacity within the decentralization process, which is also a point of contention. As Petersohn (2012) summarizes, the decentralization in France in comparison (to the UK for example) did not change the general territorial distribution of power to a large extent or caused major increases in regional autonomies. Similarly, Cole (2012) contends that the decentralization reforms ongoing since the early 2000s did not significantly alter the “basic, highly fragmented structure of French local government” (p. 120).

In the same vein, the decentralization reforms have not granted very substantial financial and tax powers to the subnational governments, which is an important point for inequalities. Nevertheless, as a result of the 2003-04 reforms, a principle of “free administration” was established, which requires regional and local governments to raise some (preponderant) part of their own revenues (Cole and Pasquier 2013). The next section will explain that most public funding still comes from central sources, as also articulated in the interviews. However, the “state steering capacity” of the central state has not effectively changed (Bezes and Le Lidec 2011; Bezes 2007).

Decentralization gave an opportunity for the state to devolve some competencies with increasing costs, but without transferring equivalent fiscal power and resources. In the 2000s, central government has increased its control over the amount of local resources, which has generated a recentralization of fiscal power in 2010 (Le Lidec 2011; Bezes and Le Lidec 2011) and introduced a negative steering that consists on limiting the resources of local authorities. In the same vein, an expert stated the following concerning how regional capacities matter for territorial reforms to be successful: “*Territorial reform at the municipal level is a problem: If they’re stronger – we can decentralize a lot of functions. However, if we reinforce the regions too much, the regions will not decentralize further, and it can trigger recentralization again. This would create discontent locally, most local politicians are careful with voters*.”

With the constitutional law of June 2003, the decentralized organization of the French Republic and regions as subnational authorities were recognized for the first time. However, as Cole and Pasquier (2013) explain, the departments received 8 billion out of 11 billion Euros transferred to all the subnational units, which also boosted their role in social policy implementation, much to the chagrin of the regional level. France signed the Council of Europe’s

European Charter of Local Autonomy in 2007 with the coming into effect of the following features: a) directly elected local authorities which were referred to in the Constitution, b) the subsidiarity principle and some financial autonomy of the local governments, and c) the right to appeal the decisions of the central state (Schondorf-Haubold 2007; Cole 2011; Marcou 2008).

Concerning how the current decentralization reforms affect the departments, another interviewed expert argued the following: “For very strong departments, which are affected negatively by these negative consequences (decentralization) in terms of resources: They have to cut non-mandatory expenses or to increase local taxes (which will create burdens).” As far as regions go, despite the ongoing decentralization process, they are still relatively weak in terms of their decision-making capacities. The Territorial Reform Act of 2010 targeted the overlapping competencies of different levels. On this, Cole and Pasquier (2013) argue the following: “Ultimately, the 2010 Local Government Reform added still further to the institutional complexity that provided the raison d’etre for the reform itself (p.80)”. Creation of a new “territorial councilor” aimed to bring together departments and regions under this post. As Cole (2011) points out, these reforms strengthened the roles of the regional prefectures. One can argue that the regional prefectures have contributed to more interactive governance. As Cole and Pasquier (2013) argue “they have claimed to provide inter-ministerial leadership of the state by way of coordinating the ‘decentralized’ services of government departments, and more recently by contractualizing with local and regional authorities and the EU” (p.78).

The regions are also gaining powers especially in terms of their role of the implementation of the EU’s policies. Especially in managing the EU structural funds for the 2014-2020, it is argued that regions will play an instrumental role. The competencies of the regions will change as a result of the recently elected “Modernization of Territorial Public

Action" law, especially in terms of managing the EU funds. One of the officially stated aims of this law is as follows:

"Finally, by operating the transfer of the management of EU funds from the state to regions, the text promotes better integration of ground realities and simplifies decision-making channels. This is a first step towards regionalization and clarifying the powers of the regions and departments will be continued in the next decentralization law that will be considered in early April, the Council of Ministers… The State entrusts each region requesting all or part of the management of EU funds for economic development, rural, agricultural or social for 2014-2020, by transferring the management or by delegation of management authority."

Whether this regionalization will result in more differentiation at the expense of the unitary system of the state is another point of concern. In the words of an interviewed expert[82], "*Regionalization is taking place to prepare a new project to facilitate the regionalization, and giving powers to the regions. The question is whether this will be similar to a federal system with similar prescriptives and competencies. We are at crossroads in France now from an economic standpoint, because we need differentiation. There is a necessity to develop territorial powers.*" The delicate balance between the differentiation of policies and the guarantee of equality has always been managed by the central state in France, and further regionalization can change the distributive dynamics, and can also contribute to rising disparities within the country. As one expert pointed out about the decentralization process: "*Regions are trying to get more powers. All but 1 has Green/social majority (in March 2014). They will get professional training in the field of public transport, environmental protection, waste treatment and planning. It won't go much further. Nowadays a new step is to give more power to urban governments (which can have an influence on distribution of resources).*" Concerning how the process is ongoing for certain regions, the following was expressed: "*The General Assembly of Brittany is asking for*

[82] Insight in this part was provided by an expert, Rennes, France, March 2014.

more regionalization. They are pushing for more cultural and political competencies and they are pushing their claims vis-à-vis the central government. For more influence, for example Alsace tried to fuse the department and the region with a unique collectivity, using regional authority to simplify the mille-feuille structure." Again, this quote shows that there is an ongoing transformation, which does not yet determine whether the urban governments, departments or the regions will end up as more powerful subnational units. The interest of certain regions to have more powers is also related to their interest in distribution and crisis-debt reduction, as this expert stated concerning Brittany: "*We want powers but also fiscal capacity, for crisis-debt reduction policies. It is complicated for governments to have the capacity to effectively distribute*".

The EU regional policies also helped accentuate the regional differences, as an expert claimed[83]: "*The EU policies reproduced the differentiation of regional capacities. Regions that have to promote interests used European resources to promote regional powers, as was the example in other Europeanization processes. Where regional configuration is more fragmented, EU reproduced the traditional French governance. This meant a strong equilibrium between small regional capacity and the traditional influence of the government. The central government used this policy to finance its own competences*". This point is also corroborated in the study of Pasquier (2003), where he shows that the "identity potential" of the Brittany was utilized to create a "regional coalition" that facilitated further cooperation between the region and the central administration, as well as creating more opportunities through the EU Regional Policy. On the other hand, Pasquier argues that in the region of Languedoc-Roussillon, the regional

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[83] Personal interview, Rennes, France, March 2014.

identity was not constructive for furthering cooperation between the central administration and the region due to the fragmentation within the regional elites. He concludes,

"*…faced with evolving challenges and opportunities, French regions so not possess identical resources. The strategies of regional and local elites over the span of a few decades have resulted in a distinct regional model of collective action in each region… In Brittany, the stabilization of relations among political, economic and cultural elites within an enduring regional coalition has made possible the elaboration of a regional development project and has forced the state to support it*" (p. 86).

Looking at another subnational level, the roles of the intercommunal public corporations – EPCI – further increased with the 2010 Territorial Reform Act and the Modernization of Territorial Public Action of 2015 – in areas such as water and sanitation. While it is difficult to show a direct causal relationship between the increase of the roles of EPCI and changes in inequality, EPCI with expanded roles can have important consequences on tax matters. As an interviewed expert stated: "This law (new reforms) could remove tax competition, organize equalization inside of each municipal corporation. The law provided compensation of taxes, for compensating the lack of resources of power of municipalities. It helped to diminish tax inequalities, so the effect of inequalities (among local governments) disappeared." EPCI actually have increased their share in household taxes (on residents and land) within the grants distributed by the central government (Cole 2012).

Again, it is important to reiterate that the subnational authorities are not always gaining more powers, as the process can also move towards more centralization as well, rather than decentralization. An expert has stated the following, "Local governments had a lot of freedom in their decision-making, this has diminished in the last 10 years." The Modernization of Territorial Policy and Cities (*Modernisation de l'action publique territorial et d'affirmation des métropoles* (MAPAM) law was passed in January 2014 in the Parliament. According to this law, the number of regions is decreased from 22 to 13 as of 2016. Some of the reforms include setting up of regional conferences of public action at the regional levels, bringing together executives of different levels, and allowing the regions to intervene in public health – which is not a mandatory regional competency. Furthermore, other department competencies are transferred to the regions in education and transport. The final text was adopted in July 16, 2015 after intense debates in the Senate. This example is another piece of evidence for the constant reorganization of territorial layers, which also changes their powers in terms of social policy capacities and implementation.

7.2.1 Quantitative indicators of decentralization: parallels with inequality levels?

The indices of France's subnational regional authority between 1950 and 2006 in the Regional Authority Index (RAI) (Hooghe et al. 2010) show that the powers of both the regions and the departments have changed over time. The local governments enjoy a certain level of revenue decentralization, but not in terms of co-determining the policies. Data from RAI show below in Table 1 the change of powers of both departments and regions over the years – the regions as of their creation in 1964 -, looking at both the self-rule and the shared rule components of the index. Here, I study both departments and regions since they are measured separately in this index.

The **self-rule** aspect of regional authority is operationalized by the variables of institutional depth, policy scope, fiscal control and representation. According to this index, the institutional depth of departments has not changed from 1950 to 2006, and they get a score of 2.0, on a scale of 0 to 3, which means that there is a non-deconcentrated, general-purpose administration subject to a central government veto. Since the powers of the departments have not substantially changed, the score does not change, yet this quantitative index cannot capture the subtle changes. As far as the regions are concerned, we see that in the last period of 1981 – 2006, their score increases from 1.0 to 2.0 as a result of the 1982 reforms, which indicates that they have transitioned from a de-concentrated subnational unit to a non-deconcentrated subnational unit, similar to departments.

The *policy scope* of the departments increased from 1.0 to 2.0 – on a scale of 0 to 4 - in the 1982 – 2006 period, which means that the authoritative competencies of the departments increased from one to at least two areas, due to increasing powers in welfare or cultural policies. For regions, this measure was 0 from 1964 to 1985 and in 1986 the score increased to 2.0 (for the period of 1986– 2006) due to increasing range of policies.

How do French subnational units fare in terms of their fiscal autonomy or their interaction with the central government in financial decision-making? This variable merits attention – as I use it directly in testing the impact of decentralization on inequality in the quantitative study. In RAI, in terms of fiscal autonomy of subnational authorities (self-rule), France's regions and departments both get a score of 1 on a scale of 0 to 4, meaning that these subnational units can only set the rates of minor taxes and that the central government collects the main taxes, as well as setting the base. The taxes, which the departments can set the base of, are: self-employed tax, mining dues, town planning tax, electricity tax and motor vehicle tax. Looking at **Table 12** and **Table 13** below, the scores of the *shared-rule* components of the RAI fare differently than the self-rule elements. Shared-rule, which is operationalized in this index by *law making, executive control, fiscal control and constitutional reform,* is weak in France. As we can see in the table below, the departments get a 0 score in all periods for these variables. Similarly, regions also have shared-rule scores of zero. In this case, it is important to emphasize the important variable of *fiscal control*: According to this index, **departments** and **regions** both have zero *fiscal control* (shared rule) – which looks at whether regional governments or their representatives are consulted over, negotiate or have a veto over the distribution of tax revenues. This is because the central government collects the taxes and sets the bases of taxes. As stated earlier, I argue that this contributes to less interactive governance.

In short, the general trend of regional authority is an upscale one, with subnational units gaining more powers since the 1950s in self-rule, but this is not matched with an increase in shared-rule in the case of France.

Table 12. Self-Rule and Shared-Rule Dimensions of the Departments in Regional Authority Index in France

Self-Rule Dimensions

Departments in France	**1950-1963**	**1964 - 1981**	**1982- 2006**
Institutional depth	2.0	2.0	2.0
Policy scope	1.0	1.0	2.0
Fiscal autonomy	1.0	1.0	1.0
Representation	2.0	2.0	3.0
Total self-rule	**6.0**	**6.0**	**8.0**

Shared – Rule Dimensions

Departments in France	**1950 - 1970**	**1971- 2006**	**1982- 2006**
Law making	0.0	0.0	0.0
Executive control	0.0	0.0	0.0
Fiscal control	0.0	0.0	0.0
Constitutional reform	0.0	0.0	0.0
Total shared-rule	**0**	**0**	**0**
Total RAI score:	**6.0**	**6.0**	**8.0**

Table 13. Self-Rule and Shared-Rule Dimensions of the Regions in the Regional Authority Index in France

Self-Rule Dimensions

Regions in France	**1964 - 1971**	**1972 – 1981**	**1982 - 1985**	**1986 – 2006**
Institutional depth	1.0	1.0	1.0	2.0
Policy scope	0.0	0.0	0.0	2.0
Fiscal autonomy	0.0	1.0	1.0	1.0
Representation	0.0	1.0	2.0	3.0
Total self-rule	1.0	3.0	4.0	8.0

Shared-Rule Dimensions

Regions in France	**1964 - 1971**	**1972 – 1981**	**1982 - 1985**	**1986 – 2006**
Law making	0.0	0.0	0.0	0.0
Executive control	0.0	0.0	0.0	0.0
Fiscal control	0.0	0.0	0.0	0.0
Constitutional reform	0.0	0.0	0.0	0.0
Total RAI score:	1.0	3.0	4.0	8.0

7.3 ORIGINS AND DEVELOPMENT OF THE WELFARE STATE IN FRANCE

Understanding the origins of the currently centralized welfare state in France is essential in understanding the impact of the territorial governance structure on distribution of resources and income inequality. According to Esping-Andersen and Myles (2009), the welfare state in general impacts the income distribution because of its provision of resources such as education, income support for working mothers (or the unemployed in the French case), as well as the fiscal policies. The idea of the state providing welfare in France, namely the French "*etat providence*" can be traced back to the 1860s during Napoleon III. Ashford (1993) argues that the French welfare state actually was founded on the principles of mutuality, solidarity and subsidiarity, and when it was established, it was actually quite decentralized. Pierson and Leimgruber (2010) explain the blend of the following two forces of the welfare state in France: people set up their voluntary organizations to provide for themselves through cooperation, and solidarity referred to the state intervention by mutuality. The subsidiarity principle referred to the semi-autonomous decision making power of workers and employers while being a part of the central state structure.

In the last decades of the 19th century, the most important local services were provided by the central government through field services. At the end of the 19th century, this was followed with the rise of industrialization and nation building, and "recentralization of the decentralized France" became indispensable through the welfare state. As Smith (2003) explains, a "new consciousness was needed" to overcome the prevalent "localism": "As late as 1900, many wealthy Parisians refused to give to a territorial unit larger than their parish… A nationally-mandated Poor Law seemed to threaten French national identity" (p.18-19).

In both France and Germany, which are considered as the continental or conservative welfare regimes, creation of the welfare state had the aim of integrating workers to the society to create more cohesion. As Pierson and Leimgruber (2010) explain:

"*Despite its explicit statism, the Bismarckian reforms above all strengthened occupational organizations and municipal institutions, giving the nascent German welfare state a much more decentralized profile than is often supposed. Meanwhile, in 'decentralized' France, proponents of Republican solidarisme such as Leon Bourgeois envisioned a strong role for the state in supporting and developing the field of mutual organizations. In both countries, contemporary economists and social scientists discussed welfare reform as a way to foster class rapprochement and the integration of the working class into bourgeois society. Seeking to tie workers to the state and to the nation was to be a means to increase the cohesion of both the French Republic and the Wilhelminian Empire*" (p.36-37).

This background is also illuminating for understanding the decentralized origins of the welfare state in continental Europe in general, since the benefits provided by the 'welfare state' of today were not initially created by the state. As Palier (2012) explains:

"*Using the notion of 'welfare state' to designate the welfare systems of continental Europe is probably misleading, since the state did not create the social insurance instruments, nor did it (and still it does not) totally finance or run them*" (p.602).

Nevertheless, even if the benefits were not provided by the central state but instead disseminated by the local governments in the past, France has seen a general increase in its centralization of governance after the two World Wars, in tandem with the development of a centralized welfare state. As an interviewed expert stated:

"*Before World War I, half of the public expenditures were met by the local governments, however the overall expenditure level was lower than now - the country was not as centralized. This had also led to the fragmentation of municipalities. The network of the field services of the central government and the representation of the central government were conducted through the mediators of the central government.*"[84] In the late 19th century, there were "administrative turf wars" against the centralization of the public assistance schemes.

After the end of the World War II, France pursued a policy to consolidate the "fragmented pre-war social institutions" and replace those with a "universalist" system, and the mediators of the central governments became the prefects of the departments (Palier 2012), an example of de-concentration. In France, the centralization of the welfare state was accompanied by administrative centralization, which originally stemmed from the strategic idea of creating a universal republican elite against the church. As Hayward and Wright (2002) state, and as also expressed in the interviews, after World War II, a strong politico-administrative elite emerged with the National School of Administration (Ecole Nationale D'administration (ENA) which produced many Presidents and Prime Ministers, as well as "the nucleus of the interlocking political and administrative state directorate" (p.26). In France, the unified political-administrative structure is closely related to the way policies are coordinated. Basing their argument on the important unified role of National School of Administration (ENA) in the administration, Hayward and Wright (2002) claim, "Many of the strengths and weaknesses of the distinctive French style of policy coordination derive from this impulse to unify" (p.25).

[84] Personal interview, Paris, France, March 2014.

The Gaullist Pierre Laroque created the Social Security Plan (Plan de Securite Sociale) in 1945-46, which aimed at providing social insurance for all the people, but it was to be financed by payroll contributions of the employees as well as tripartite cooperation between the state, trade unions and employers' federations (Pierson and Leimgruber 2010; Palier 2002). Therefore, the inclusion of these organizations in a standardized manner was very much the aim at that time. The second half of the 20th century witnessed an expansion of the welfare state in France. While looking at the fiscal and social policies of France, it is important to keep in mind that the transition from a local or parish oriented welfare system to a national one, as it is now in France, was a big move that necessitated big changes in the power relations and the political allegiances (Smith 2013).

Nevertheless, the main idea that prevailed was the social protection aimed at providing job and income security for male industrial workers (Palier 2012). The social identities were also born out of work and "collectively negotiated rights". "The social question" - *la question sociale* - aimed at providing political and social integration to the workers, rather than overcoming poverty or inequality, while they did ensure low levels of inequality. This is in line with the classification of the welfare state regime of France as a conservative regime that is founded upon the recognition of status, and one that protects its senior citizens at the expense of unemployed youth, and has medium levels of de-commodification with most financing coming from social contributions (Chauvel 2013; Palier 2012; Esping-Andersen 1990). While the welfare state was first founded on statutory social protection principles, in 1958, anon-statutory unemployment insurance was founded with the negotiating of the social partners (Seeleib-Kaiser et al. 2012). On this issue, Palier (2012) argues:

"*As far as social justice is concerned, these schemes are less concerned with poverty or inequality than with ensuring the proportionality of benefits in respect of former wage levels and contribution records, i.e. reinforcing the so-called equivalence-principle (which also prevailed in Germany as Aquivalenz-Prinzip*".

In Esping-Andersen's (1990) welfare state type indices, France ranks high on the corporatism index, only behind Italy, (measured as number of occupationally distinct public pension schemes) and the highest among 18 welfare states in terms of etatism (measured as expenditure on pensions to government employees as a percentage of GDP). However, whether France has been corporatist in the Schmitter (1974) sense of the term, or neo-corporatist has been debated, which I will explore in more detail in the section on interactive governance of France. Wilson (1983) shows that the French system is better described a pluralist, rather than a corporatist system, using findings from interviews with the leaders of the employer and employee organizations, a point I will return to in the section on interactive governance. In Castles and Mitchell's (1993) welfare regime categorization, France is considered to guarantee low benefit equality (guaranteed equality as a percentage of the legal maximum benefit possible) while social security and welfare transfers levels are high as a percentage of GDP.

Based on the background information on the welfare state, I turn to the subnational financing and fiscal and social policies, focusing on how the territorial governance structure impacts the way they are determined or funded or implemented. This discussion first starts with a look at the national and regional income inequality levels in France, in order to point out the correlations between decentralization, the policies and the inequality levels.

7.4 THE RECENT INEQUALITY TRENDS IN FRANCE AND FISCAL AND SOCIAL POLICIES THAT MATTER FOR INEQUALITY

Before looking at the fiscal policies and social policies that matter for inequality in the next section, I first provide an overview of the national inequality and income distribution trends in France over the years. In France, income inequality declined gradually during the course of the 19th century; showed an increase during the Great Depression and with the World War II, it decreased again (Boix 2015). Atkinson (2015) argues that the "*postwar reduction in inequality in Europe, was not, solely achieved by redistribution. Both wage and capital incomes were- at times – becoming less unequally distributed*" (p. 68). Therefore, understanding inequality necessitates a look at both changes in the wage structure as well as redistributive efforts of the state.

7.4.1 National inequality levels in France

OECD classifies France as a country where there was no significant increase in inequality from the mid 1980s to the mid 2000s. As Fremeaux and Piketty (2014) explain, the decrease of inequality in France in the 1970s and 1980s made it stand out among the developed countries.[85] However, the decade of 2000 - 2010 and onwards has seen an increase in the inequality levels. **Figure 16** below displays the fluctuation of the **net income inequality levels (after taxes and transfers)** and of the **market income inequality levels** (before taxes and transfers) in France

[85] The authors base this on disposable income inequality, which measures earnings, pensions, welfare benefits, capital income minus taxes.

according to the Standardized World Income Inequality Database (Solt 2016) for the years that I cover in the statistical study of this work, starting with the 1960s. This chart shows how much taxes and transfers actually had an impact on the inequality levels in France, usually decreasing inequality about 20 percentage points. There is a parallel between the disposable and gross income inequalities. **Figure 17** shows the net redistribution in France, which is found by market income inequality minus net income inequality.

As the chart indicates, there is a slight decrease in the redistribution level of the welfare state in general, which I will elaborate on in the next section to test whether it is affected by the territorial governance structure of France. The difference between the gross (market) and net income inequality – showcasing redistribution - was at its lowest in 1970, a time when gross income was at its nadir. After this point, inequality levels had mostly been on a decrease until the mid-1980s. After a rise in the mid-1980s, inequality decreased again until 1990 and followed a quite flat path until the late 2000s onwards.

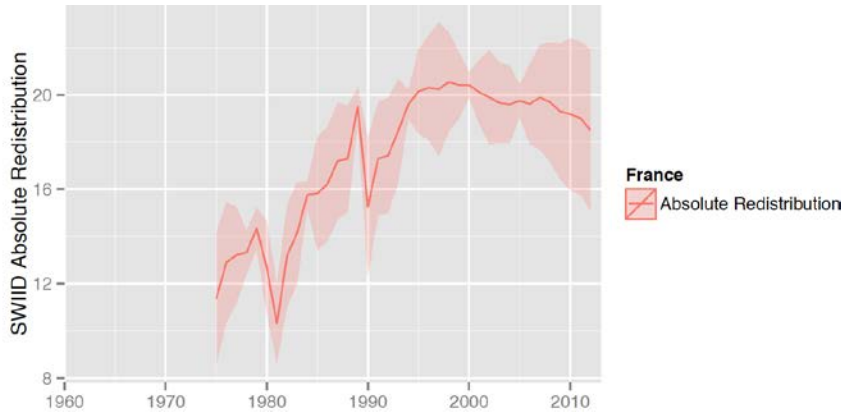


Figure 16. National Income Inequality Levels in France (Market Income Inequality and Net Income Inequality)

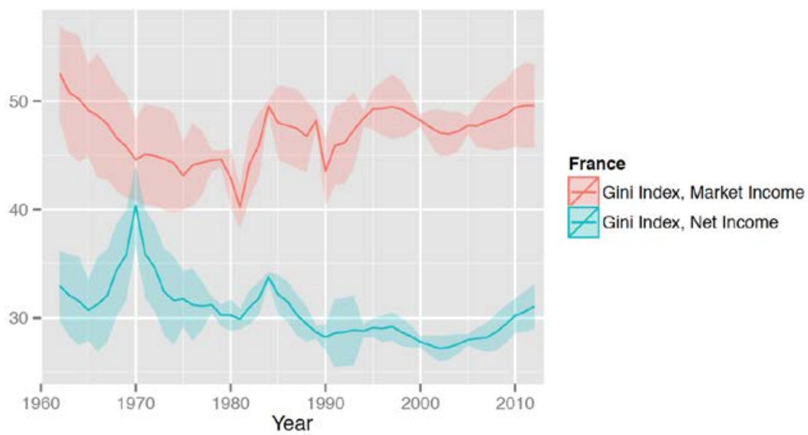


Figure 17. Absolute Redistribution in France (Market Income Inequality minus Net Income Inequality)

Source: Solt (2016)

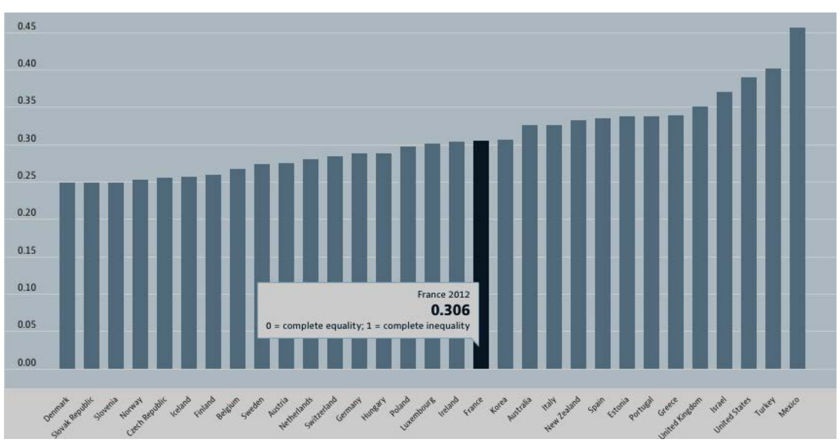


Figure 18. National Income Inequality in the OECD Countries and in France in 2012

Gini index range from 0 to 1, 0 indicating perfect equality, 1 indicating complete inequality
Source: OECD (2016)

Figure 18 above shows the 2012 (household) net income inequality levels of France, showing its position among the other OECD countries. Looking at the cases covered in this work, only Spain exhibits higher inequality levels than France (the two countries classified as non-interactive governance), whereas Sweden and Germany have lower inequality (countries with higher interactive governance). France has lower overall national household inequality levels than many countries in Europe, such as the UK, Italy, Greece, Spain, Ireland; has similar inequality levels such as Belgium and Luxembourg, and higher inequality than Scandinavian countries and the Netherlands. Therefore it is classified as a medium inequality country with a *Gini* level of 0.3 (on a scale of 0 to 1) for the year 2012. France is one of the few countries in Western Europe that has not experienced a drastic increase in its national or regional (interpersonal) inequality levels between 2000 and 2010 (OECD 2008) despite increases of a few points. However, this trend has reversed and currently France is an OECD-average country after 2010 with its inequality rising more than many other OECD countries, such as the US or Germany.

In order to match different periods of decentralization with inequality levels to apply the theory of the dissertation to the French case, we see that the decentralization reforms of the early 1980s coincide with increasing income inequality during that time, as Figure 13 shows. While this merely suggests a correlation between decentralization and inequality, it still warrants attention. As I will explain later in the section of redistributive policies, the general non-progressive nature of taxation contributed to the increases in inequality in general and the highest levels of inequality were reached in the mid-1990s.

As indicated in the theoretical chapter, there are other measures of inequality in addition to the *Gini* index. According to Piketty-Zucman data, **the share of wages in national income** in the 1950s, 1970s and 2000s, as ten-year averages, never decreased below 75 percent in France, rising to 80 percent at its peak in the 1970s and being slightly above 75 percent in the 2000s (Atkinson 2015). In the 2000s in Germany, this level was slightly above 70 percent, less than that in France (Atkinson 2015). As Piketty (2014) suggests, the overall trend of inequality is different than many other European countries that experienced a surge in their inequality measures. This implies that a rise in the share of wages in the total gross income is significantly related to lower inequality. This is based on research by Checchi and Garcia Penalosa that looks at the 16 OECD countries in 1970 – 1996 and the result is that a 1 percentage rise in the wage share is associated with a 0.7 percentage point decrease in the Gini coefficient. According to Atkinson (2015) the most important factors for a reduction in inequality in postwar France are the increase of wages in total income and the fact that capital and wage incomes became distributed less unequally. After the increase in inequality in 1964, the downward trend was credited to minimum wage policies of the French state, which is a feature of the welfare state (Piketty 2014, p. 73; Atkinson 2015). In France, the proportion of the population living in households with incomes below 60 percent of the median fell from 18 percent in 1970 to 14 percent in 1990. Stiglitz (2015) argues that these are mainly attributed to the welfare state and social provision expansion and progressive income taxation, the maturing of state pensions and cash and transfers. The following section provides a more detailed look at fiscal and social policies for changes in inequality especially in the recent years that can be attributable to the territorial governance structure.

The OECD argues that after improvements in the 1990s, the tax-benefit is now not effective in stabilizing inequality, which can be argued to be a contributing factor to increasing inequality, since benefits did not increase as much as real wages since the 1990s (OECD 2011).

Going back in time, Atkinson (2015) attributes the decline of inequality in the postwar period to the share of wages in total income and the less unequal distribution of wages. In the postwar period the rising share of wages contributed to decreases in inequality until recently. For this reason, the standardized redistributive policies, which are related to the unitary structure of France, are key to generally low levels of French inequality.

Another important measure related to inequality is the **share of top 1 percent or the share of the top decile** in the overall income generated in a country. From the beginning of World War I until the end of World War II, the share of the top 1 percent in total gross income decreased from 18.3 percent to 7.5 percent in France (Atkinson 2015). The share of the top 1 percent in total gross income decreased from 9.9 percent to 7 percent from 1961 to 1983, which, according to Atkinson, does not indicate a salient fall (Piketty 2014; Atkinson 2015). According to the OECD (2011) the share of the top 1 percent of incomes only went up from 8.2 percent to 8.9 percent from 1990 to 2006, which was substantially a lower increase than those that occurred in the English-speaking OECD countries.

Meanwhile, the earnings dispersion in France did not show a dramatic increase in the period of 1954 – 1989 either. The share of the middle class in total gross income has decreased in all the OECD countries except Denmark and France (Stiglitz 2015). The earnings of the top decile (P10), measured as percentage of median income (P50), went from around 200 percent of the median in 1954 to about 210 percent of the median in 1964. It had a plummeting trend until 1980s, and it went up to only slightly above 200 percent in 1990. In 2012, the earnings of the top decile amounted to about 190 percent of the median (ratio 1.9), which is the fourth lowest in the OECD, as displayed in **Figure 19** below. I will return to these changes in inequality when I explain the politics behind the changes and how the process of decentralization might have significantly impacted the income inequality changes.

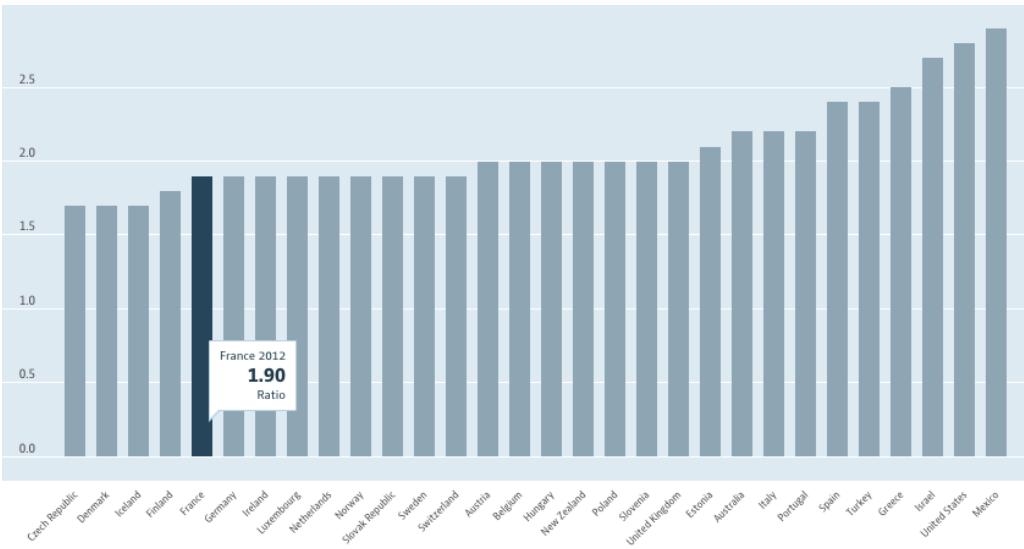


Figure 19. National Income Inequality, Inter-decile P50/P10 Ratio in France in 2012

Source: OECD

7.4.2 Regional differences and regional inequality figures

In addition to national inequality figures, we can examine the subnational differences by looking at the GDP levels of each region, as well as regional *Gini* inequality levels before looking at fiscal and social policies. **Figure 20** below shows the regional *Gini* inequality levels of the regions before and after taxes and transfers for 2010 using data from the OECD. The first two columns show the average French inequality levels, followed by the regions. Looking at this chart, regional inequality scores range from 0.26 to 0.35 on a scale of 0 to 1. The regions of *Île-de-France* and Corsica have the highest inequality levels. In the case of Corsica, the regional *Gini* levels before taxes and transfers is 0.61, which is the highest in France and redistributive instruments bring its net income inequality to levels comparable to *Île-de-France* and Alsace. As the region with the highest GDP, Île-de-France also exhibits the highest net inequality after Corsica.

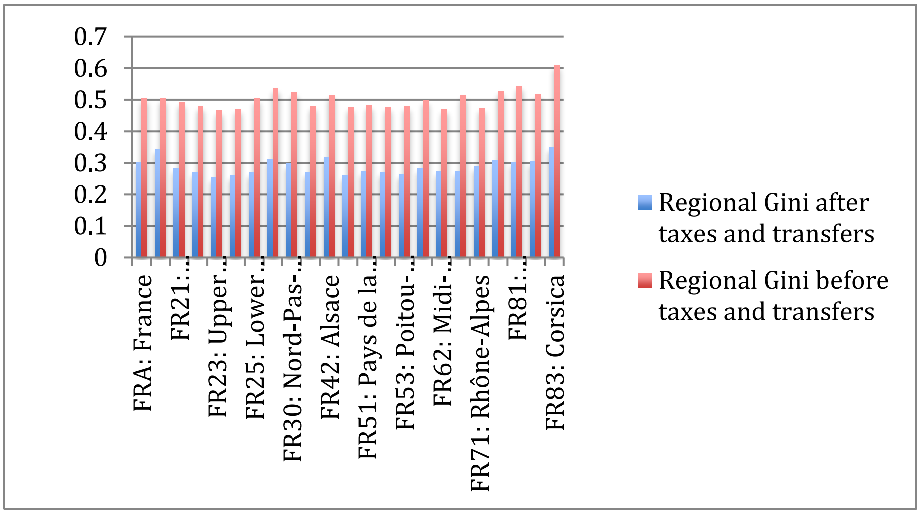


Figure 20. Regional Income Inequality Levels in France in 2010

Source: OECD

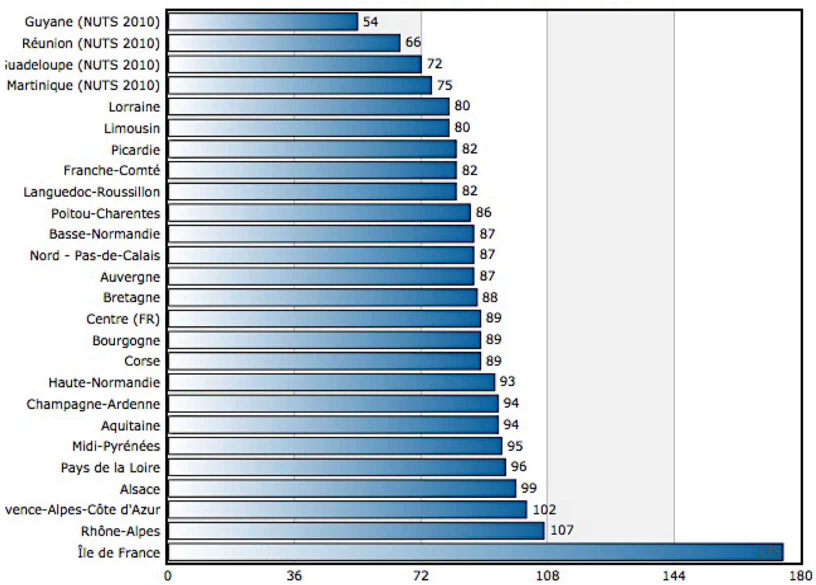
Gini inequality measured on a scale of 0 to 1

The centralized nature of public investment funding in France is also important in understanding how spatial differences can lead to economic differentiation among the regions, since the center produces and also receives investment much more than the rest of the country. If we look at how much GDP is produced by each level overall in Europe's NUTS-2[86] regions – which correspond to the **regional** level in France - , France is among those countries whose capital regions had more than 50 percent higher GDP per capita than its other regions – along with the capital regions of Sweden, the Netherlands and Denmark (Eurostat), showing the

[86] As classified by the European Union, Nomenclature for Territorial Statistics (NUTS-2): basic regions for the application of regional policies, http://ec.europa.eu/eurostat/web/nuts/overview

concentration of GDP at its center. As **Figure 21** shows below, the gross regional domestic product of Île-de-France - measured in purchasing power standards per inhabitant, as percentage of the EU-27 average – is 175 percent of the EU-27 average, whereas the next highest region, Rhone-Alpes, trails Île-de-France with 107 percent.

S



Source: Eurostat – European Commission

Figure 21. Regional Gross Domestic Product in Purchasing Power Standards in France in 2010

The overall redistributive effect of services such as health and education are estimated to be valued at 6600 Euros per person, which is calculated by the OECD to increase the average incomes to 26000 Euros, and causing a one fifth reduction in inequality (OECD 2011), showing the strength of the central state in welfare in France. Nevertheless, as Le Gales (2006) explains, the geographical inequalities are at the core of the French political debate and it also impacts redistribution:

“*Spatial differentiation leads to increased inter-territorial conflicts for welfare redistribution and increased competition for what remains of State investments. The question of geographical inequalities remains central to the political debate and evolution of the French Republic. Interestingly, the structure of territorial inequalities has followed a particular path. By all accounts, the dual structure of the rich Paris region on the one hand and the rest of the country on the other remains the central feature*” (p.206).

Le Gales (2006) illustrates how the differences in regional production can affect inequalities: "*Two contradictory points are crucial. In terms of GDP per inhabitant and in terms of productivity, the gap has increased between the Île-de-France region and the rest of the country since the 1980s. Île-de-France comprises about 23 per cent of the population and produces about 30 per cent of the GDP. In similar measure, the same gap is increasing between cities and the rest of France*" (p. 207). However, these forces have not translated to a very unequal national income inequality levels in France or regional income inequality levels in France, at least until the decade of 2010s. A study that looked at the progress of regional inequality in France from 1860 to 2010 shows that the latter decades of the 20th century witnessed the largest increase in terms of regional inequality. This was mainly attributed to the changes in the industry, to the increases in the service sector, technological changes and the variations in wages (Enflo and Rosés 2015). Another reason for regional inequality related to the territorial governance structure is the fact that the population of Île-de-France is getting younger. However, GDP per capita is not a perfect measure of regional inequality, and in terms of post-transfer income, regional inequality was declining, with a study done in 2001.

Regions such as Limousin or Languedoc Roussillon have populations that are getting older with more emphasis on pensions and redistribution, as well as tourism (residential economy) (Davezies 2001, quoted in Le Gales 2006, p. 207). Le Gales (2006) links this increase in regional inequality to the interest groups that are against regionalization of welfare or social issues that would threaten the large-scale redistributive mechanism. Therefore, this is another non-interactive pattern that shows how the balance between centralization versus regionalization has not exactly been resolved in France.

7.5 WELFARE STATE AND THE FISCAL AND SOCIAL POLICIES IN FRANCE THAT MATTER FOR INEQUALITY

To establish the causal mechanism between the territorial governance structure, decentralization and inequality in France, it is necessary to explain the *fiscal and social policies* that are related to, or directly stem from this unitary and partially decentralized governance structure, which in turn are likely to impact income inequality. In today's France, the centralized nature of the state is visible in the way these policies are *determined and funded* and but its decentralized features are also evident in their *implementation*. Furthermore, local governance has become more salient with recent reforms. The decentralized features of the state - in terms of the competences of the local government – add to the complexity of assessing the impact of the territorial structure on inequality. In the words of an interviewed expert, who linked the territorial governance structure directly to inequalities, "*France is different from the other European countries, because it is a country where 50 percent of the public expenses are made up of* ***pension and health*** *(provided by the central government). The social security is neither decentralized nor undergoing decentralization (we see administrative decentralization, but not fiscal decentralization). This compensates inequalities generated by the local governments.*"[87] Therefore, the lack of high subnational fiscal autonomy overpowers any discrepancies that could have emerged by the small levels of fiscal decentralization as a result of the decentralization process (mainly revenue

[87] Personal interview, Paris, France, March 2014.

decentralization). Because of the high impact of the standardized welfare state policies of this unitary structure, France has sustained low levels of overall national inequality, despite the fact there is not a high level of fiscal shared rule between the central government and the subnational units – which I argue should be associated with lower inequality as a feature of interactive governance.

France is a case of a unitary state with strong central state presence for welfare state policies along with decentralized features, and the low-interactive nature of governance – as I will explain subsequently in the chapter - structure does not have a strong enough impact to offset the equalizing policies of the welfare state in France. Nevertheless, there have been increases of inequality, especially in the last five years which merit attention, which can partly be explained by the territorial governance structure and the low interactive nature of governance. Furthermore, the regional differences remain high, which I will illustrate by looking at the different production levels of the regions.

7.5.1 Redistribution and regional differences: taxes and transfers

If we look at overall social spending per capita in France, it has enjoyed a growing level since 1980s. France was spending 21.1 percent of its GDP on social spending, and it was 27.2 percent in 2001, which was even a slightly higher amount than Sweden (Smith 2013). France's net public spending and net social spending figures have been on the rise since 1980s. It is worth comparing France with another unitary and more decentralized country with higher interactive governance, Sweden. **Figure 22** below shows the level of spending of France and Sweden as a percentage of GDP, based on OECD data.

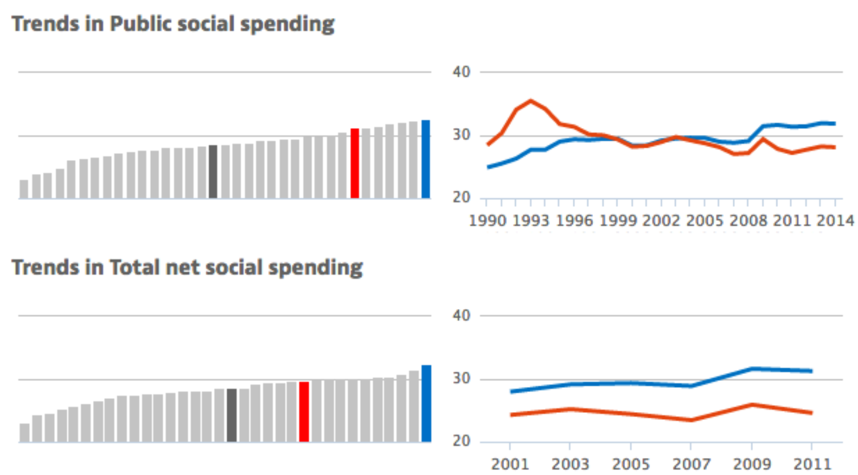


Figure 22. Public Social Spending and Total Net Social Spending in France and Sweden

Source: OECD

Spending shown as a percentage of GDP.

Blue lines indicate France and red lines indicate Sweden. The black bar shows the OECD average.

The centralized nature of the French state manifests itself in its taxing and redistributive policies and its aims for equality. Historically, taxation has been a very important element in understanding redistribution and inequality, more so than many other countries mainly because of the importance of tax revenue in overall GDP (44.2 percent in 2011 (Fremeaux and Piketty 2014). Fiscal equalization, in terms of both fiscal capacity and the fiscal revenue of subnational governments remains atop the goals of the French government (Reschovsky 2007). The redistributive system in France rests on state transfers (intergovernmental grants) as well as local taxation. The relevant levels for redistribution and taxes are regions, departments and municipalities (communes) and inter-municipal public corporations. As explained earlier in the section on decentralization, the tax system is quite centralized.

Personal income taxes replaced some parts of the social security contributions that went into financing family and health benefits in 1997, which is considered a major change in the taxing system in France. Fremeaux and Piketty (2014) argue that overall, the personal income taxes are not progressive and the reforms in 1997 and 2012 have not led to more progressivity. They claim that there is a considerable amount of inequality of taxation and disposable income in France and go on to say the following: "The failure of the tax system has important consequences for inequalities since taxation increases market income dispersion" and that it can have serious consequences for France since the public's tolerance for inequality is low (p. 268). Since no serious fiscal reforms have taken place to increase either the self-rule or the shared-rule of the subnational units to a significant extent in France, the progressivity of the tax system concerns only the central level. Therefore, rather than trying to establish a dynamic impact of the taxing system on changing inequalities, understanding the impact of the centralized level of this system is key, when talking about the impact of the territorial governance structure on inequality.

7.5.2 The French redistributive system: how redistributive?

France first imposed a tax on income in 1914 (earlier the Senate had blocked it since the 1890s), and it was adopted in 1914 (Piketty 2014). According to 2012 figures, the ratio of tax to overall GDP was 45 percent in France, which was the third highest in the EU. Furthermore, in terms of share of revenue that benefits the social security funds, France shows the highest percentage in the EU with 54 percent. In France, the bottom 50 percent of the income distribution pay a rate of 40-45 percent and the next 40 percent pay 45-50 percent. However, the top 5 percent and the top

1 percent pay lower rates: Top 0.1 percent pays only 35 percent. High tax rates on the poor demonstrate the importance of consumption taxes and social contributions (Piketty 2014).

As stated above, the French taxation system is regarded as one of the least progressive tax systems (which together account for three fourths of the French tax revenues) (Piketty 2014; Fremeaux and Piketty 2014). Furthermore, the progressivity level of taxes differ from one another which as implications for the territorial governance structure. While the workers finance social security contributions, the contributions go to the pool, which is used for financing family, or health allowance benefits that are considered universal, which is a reflection of the standardized redistributive system. As Fremeaux and Piketty (2014) explain, the social security contributions of the employees account for 40 percent of the overall taxes, whereas around 26 percent come from taxes on goods and services, and taxes on income, capitals gains and profits account for 20 percent. Also the weight of the social security contributions in taxes is largest in the OECD countries, whereas it is the opposite for the direct taxes such as personal and corporate taxes. Based on the studies of Bozio et al. (2012) on the progressivity of the taxing system in the last fifteen years, Fremeaux and Piketty (2014) argue that the failures of the – central state's - French tax system contributed to the rise "*the inequality of taxation on disposable income since the end of the 1990s*" as well as the dispersion in market incomes – which exists independently of the state policies. Fremeaux and Piketty claim that the tax reforms of 1997 and 2012 are to blame for the regressive nature of the taxes and the overall tax rate decreased 0.6 points along with a 3.6 decrease for the top 1 percent. They state that: "*The failure of the tax system has important consequences for inequalities since taxation increases market income dispersion. More importantly, it can also lead to distrust for the system of taxes and transfers and, more* *generally, for the political institutions, especially in France where tolerance for inequality is low*" (p. 269).

France's tax and redistributive system has its shortcomings, but looking at it from a more general perspective, it has led to high level of territorial standardization. On this point, Davezies (2008) argues: "*Indeed, it is these redistribution instruments, which are the main instruments of territorial cohesion in France today. The budget of the state and Social Security operates today without proper territorial intention of levies roughly proportional to revenue of households and thus territories: second, it performs roughly equal spending per capita*" (p.53). Concerning how the French social security system had implications for the inequalities, an expert claimed the following:

"The French social security system reduces differences between territories strongly and even creates other inequalities to benefit to the less dense territories. For example, the suburbs around Paris become poorer. The second element is the residential economy: They spend it on the countryside. Retired people have the majority of the inherited status and they are mobilized voters who have a lot of strength, contrary to young people who don't vote as much as them, therefore the governments prefer catering to them".[88]

To assess the redistributive impact of the welfare state, the movement of income among the different income groups is also telling, in addition to the *Gini* levels. Mahler, Jesuit and Paradowski's (2013) study looks at the effect of taxes and transfers on five income quintiles, by ranking households by their pre-tax and pre-transfer incomes, in five different income groups for the years of 1979 – 2006. Then by adding taxes and deducting transfers, the authors conduct

[88] Personal interview, Paris, France, March 2014.

another ranking, the results of which are shown below.[89] Among the 14 countries that are in this study, France ranks among the highest redistributors when we look at the movement from Q1 to QII, QIII or QIV, with more than Germany or Spain. The table below shows the changes in the shares of income quintiles. This study does not take into account the recent increases in inequality after 2010.

Table 14. Changes in the Shares of Income Quintiles in Overall Income in France, 1979-2006

France	QI	QII	QIII	QIV	QV
Pre-government shares	0.8	8.3	15.3	23.1	52.5
Post-government shares	7.4	12.1	15.6	20.3	44.7
Redistribution by share	6.5	3.7	0.3	-2.8	-7.8

Source: Taken from Mahler et al. (2013)

Similar to Sweden, to understand the impact of taxes and transfers in France, wage inequality figures are also informative. In France, the gross income gap between labor market insiders versus labor market outsiders[90], before taxes and transfers is similar to the figures of other continental countries (about 22.7 percent). The effect of taxes and transfers makes this gap larger in France, unlike Sweden, the UK or the Netherlands, using data from 2000 (Häusermann and Schwander 2012, p.38-39). Also, looking at social spending, most of it was not means-tested and was targeted to the poor and the employed, highlighting the divide between insiders and

[89] Study by Mahler et al. 2013. Using data from the LIS database, other countries in the study are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, the Netherlands, Norway, Sweden, Switzerland, UK and the US.

[90] Outsiders are operationalized as the "individuals who belong to occupational groups (defined by class, gender and age) that are significantly more strongly affected by unemployment or atypical employment" (Häusermann, and Schwander 2012, p.47). The effect of welfare states (taxes and transfers) is measured both at the household and the individual level.

outsiders. The net income ratio between insiders and outsiders in France is 67.5 before taxes and transfers, and 59.6 percent after taxes and transfers, using data from Luxembourg Income Study for the year 2000. In France, Germany and Spain, taxes and transfers benefit the insiders, with the highest benefit in insiders accrued in Spain.

France's redistributive policies are known to have a significant effect on poverty reduction. France's poverty reduction in families with children in mid-1990s was calculated to be 75 percent, by decreasing 40 percent market poverty to 10 percent poverty (Van Kersbergen and Vis 2014, p.92). One expert expressed the following concerning the level of redistribution in France, highlighting concerns about whether keeping under control the growth of public expenditure and social security public expenditure could be a problem for France: "*Maintaining high redistribution within France process is not going to work since tax incomes are decreasing. There is a developing black economy, which we are not able to match. Even the public finance system is not in equilibrium. The tax you pay for the social system will not be given back. For example, Germany used devaluation to face economic competition.*"[91]

7.5.3 Social policies and redistribution in France

To understand how redistributive the French welfare state is, looking at some social policies is also instrumental, especially with regard to the territorial governance structure based on the argument of the dissertation. According to Cazenave et al. (2011), social spending, such as

[91] Personal interview, Paris, France, March 2014.

housing, family and social assistance account for 66 percent of the income inequality reduction in 2010, in line with the OECD statements I presented earlier.[92] One of the social policies that is currently impacted by the territorial governance structure in France is the "Active Solidarity Income" - (*Revenu de solidarité active* - RSA), which is a type of work welfare benefit with the goal of decreasing barriers to return to work and to simplify the welfare system (OECD). It was first implemented in June 2009 by the French government replacing the Minimum Income (*Revenue Minimum D'Insertion* – RMI), which had been operational since 1988 in France with coverage gradually increasing since the 1990s. Vlandas (2013) argues that the reform that created the RSA was an example of an alliance between the employers and the conservative party, and also the socialists as well, indicating interaction.

The main purpose of the RSA is to provide a minimum income for people who are unemployed or underemployed, which benefits low-wage workers as well, requiring them to look for work or training (Smith 2013). RSA income varies depending on the composition of the household and people with children earned more, up to 980 Euros (RSA, French Public Service). The territorial governance structure matters for the RSA mainly because of the way it is funded. As an expert expressed, "*RSA territories with the minimum income fee is paid by the provincial elected local governments. The 2003 decentralization was financed by the departments – on their own fiscal resources, which can lead to overall disparities among the regions*" [93]. This policy, which provided counseling to long term unemployed groups was 80 percent financed by the central governments, and the rest by the departments. Another concern for the department

[92] According to Cazenave et al. (2011) – as presented in Fremeaux and Piketty (2014), within this 66 percent reduction in inequality, 26 percent comes from family benefits, 19 percent from housing benefits and other social assistance, such as minimum income, elderly and disabled pension 17 percent (p. 269).
[93] Personal interview, Paris, France, March 2014.

level is that since the population is getting older, the percentage of people that is concerned by the RSA is increasing on a dynamic level.

The welfare state reforms brought by Sarkozy focused on the special pension regimes of the public sector which aimed to correct the so-called “corporatist excess” where people could retire in their early fifties with the full pension (Smith 2013). In 2007, 3.5 million people had benefited from RSA (Palier 2012). According to OECD data, the general unemployment spending in France, measured by cash and benefits for the unemployed and people retired early has not showed a great fluctuation between 1997 and 2007 (Hemerijck 2013). However, the active labor market policy as a percentage of GDP has showed a slight decrease. Despite the fact that insiders – in terms of “workers” - are more favored in France, guidance and training programs targeting outsiders have increased their importance in the last two decades since there are more benefits for part-time workers such as maternity paid leave and minimum income protection (Hemerijck 2013) which can have a positive effect on reducing inequalities. In a move that contributed to sharpening the insider/outsider divide, we see that the government decree created different benefits streams of unemployment insurance based on contribution history, in addition to age. Clegg (2012) argues that the discussions of unemployment insurance after that time mainly rested on economic conditions determining whether they would be more expansionary or restrictive. In the 1990s and in the 2000s, the unemployment insurance cuts mainly impacted those that had not been attached to the labor market for a long time. Nevertheless, about 40 percent of the social spending in France, such as health policy or family benefits, is not contingent on the household or individual income, while the rest including social assistance and housing benefits are means tested (Fremeaux and Piketty 2014).

It is important to talk about health policy in France in the context of the impact of decentralization, due to the centralized nature of this policy. As the interviews show, health policy is rather centralized in France, currently even more so than the past especially after the 1990s. There is universal health coverage since 2000. As Axelsson et al. (2007) state, there is a "*radical and structural split between financing and provision of health care in France*", and the whole system is steered by the state while trade unions and employers associations manage the *sickness insurance* – a key part of health coverage - emanating from the Bismarckian principles. Since there are health targets set by the Parliament for the whole country, Axelsson et al. (2007) argue that this shows "a process of centralization where the state assumes the responsibilities of the delegated agency of the social security system" (p.148). The health system reform law of 2009 has changed the outlook of health policy especially in terms of provision: "*Public hospitals are no longer public operations. There are regional health agencies appointed, but the financial framework is determined nationally. In this respect, Spain and Sweden are more decentralized than France.*"[94] The public-private partnerships, such as *societies d'economie mixte* (private agencies with majority public ownership) are important for local governments (Le Gales 2006). It is important to note that the "mixed corporations" and *etablissement publique* (EPA)[95] are used for development and housing purposes and this is argued to fit the "strong state/weak voluntary tradition" which France exemplifies (Savitch 1998). The regional hospital agencies were established in 1996 for coordinating health services at the regional levels but again, they can also be considered as an example of de-concentration "an increasing state involvement in the health system as a whole" (Axelsson et al. 2007, p. 149). Again, we see that

[94] Personal interview, Paris, France, March 2014.
[95] EPAs are administered by managers that are publicly appointed but they operate with the private sector.

France is blending centrally determined principles with relatively decentralized provision in social services.

Departments are in charge of grants allowances to handicapped and elderly people and to people out of the labor market. In the words of an expert: "*The problem is the following: You have the national level: The department has very little to decide – according to the law the department can do better if they have the money to do so. There is a lot of inequality in the financing of the resources of the departments. This fulfills a duty of solidarity – no appropriate discussions left in order to decide how far they want to support. This would be done nationally and it poses a risk for older people.*"[96]

It is argued that in France "*seniors are more equal because they are the homogenous cohorts of the wage earner society*" of the 1960s and 1980s (Castel 1995; Chauvel 2013, p. 123). According to Chauvel (2013), there is a decline in the intra-cohort of the seniors in France, because the pensions of all the seniors increase, reflecting the uniformity of the territorial governance structure. However, younger adults have more polarization of winners and losers, or in other words, outsiders and insiders (Brzinsky-Fay 2007; Chauvel 2013). In a similar vein, an expert claimed the following on the importance of horizontal equalization and how it impacts the purchasing power of people: "*There are demands of the department level concerning the deficits, between the resource of transfer and costs, 3.8 billion a year. This affects some departments, which do not benefit from selling housing tax. There was equilibrium because of the housing bubble, it helped between costs and resources. But since 2007 – 08, the gap has increased which necessitates more* ***horizontal equalization*** *to correct main inequalities. Strong horizontal*

[96] Personal interview, Paris, France, March 2014.

transfers are needed between the territories. Even with a life of work, you cannot buy an apartment! The inequality between generations is also an important element of the current situation that worsens the economic conditions of the people. People expect to get a nice flat from parents, because it cannot be bought by working."[97]

To sum up, concerning how the territorial governance structure impacts inequalities through social policies, an interviewed expert stated the following, "*The fact that the competence of social transfers were transferred to the department level (increased inequality). This was done in order to save the department level which was to be suppressed, and there is local mobilization to limit the expansion of inequalities*".[98] The territorial dimension was expressed as an important element that impacted social spending in all the interviews, however the direction of this impact was unclear. On this note, Davezies (2008) states the following: "*The territorial dimension of redistributive public and social budgets is even more unclear. The question of what the territories are "winning" or "losing" the game of these budgets remains open*". Smith (2013) argues that "France's welfare state was more or less the same in 2012 as it had been in 2007. It was a case of *rupture manquee"* (p. 199).

7.5.4 Local taxes and intergovernmental grants in France

While the welfare state is very centralized in France, it is important to look at subnational (or local) taxes to test whether they have any bearing on regional or national inequality. According to the OECD figures, the share of subnational tax revenues in terms of total tax revenue in

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[97] Personal interview, Paris, France, March 2014.
[98] Personal interview, Paris, France, March 2014.

France has not substantially changed in the last 20 years, and still remains low. In 1995, 11 percent of the total tax revenue came from subnational tax revenues (local taxes)[99]. In 2008, subnational tax revenue rose to 12.1 percent, and in the latest figures from 2011, it was 13.1 percent. Currently, these numbers are 29.3 per cent for Germany, 32.3 percent for Spain and 35.7 percent for Sweden, indicating higher numbers. Therefore, the relatively low subnational tax revenue is evident in the case of France (Blöchliger and Nettley 2015). The central state decides on the revenues of the territorial communities, indicating the centralized nature of how local taxation is determined, as illustrated in the Article 72-2 of the Constitution:

Territorial communities shall enjoy revenue of which they may dispose freely in the conditions determined by statute. They may receive all or part of the proceeds of taxes of all kinds. They may be authorized by statute to determine the basis of assessment and the rates thereof, within the limits set by such statutes. Tax revenue and other own revenue of territorial communities shall, for each category of territorial community, represent a decisive share of their revenue. The conditions for the implementation of this rule shall be determined by an Institutional Act. Whenever powers are transferred between central government and the territorial communities, revenue equivalent to that given over to the exercise of those powers shall also be transferred. Whenever the effect of newly created or extended powers is to increase the expenditure to be borne by territorial communities, revenue as determined by statute shall be allocated to said communities. ***Equalization mechanisms intended to promote equality between territorial communities shall be provided for by statute.*** [100]

Both legislative chambers adopt constitutional laws in France and they are subject to popular referendum, but statutory laws, which can create new subnational units are exempted from this process (Petersohn 2013). The local financial autonomy came with the Constitutional amendment of 2003, more specifically with the inclusion of the Paragraph 4 of the Article 7-2of

[99] According to the official French Tax Code (2011), there are four main local taxes – property tax on developed land, property tax on undeveloped land, residence tax and the local economic contribution as well as some additional or similar taxes.

[100] 1958 Constitution, http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/constitution/constitution-of-4-october-1958.25742.html#TitleXII

the Constitution, which put forward the idea that if local authorities would gain more powers, additional resources would also be provided to those authorities, to be set out by law (Marcou 2008). As stated in the Organic Law of 29 July 2004 on the Financial Autonomy of Local Authorities, the state collects local taxes on behalf of local authorities of regions, departments and communes and EPCIs. Known as the oldest taxes of the French tax system created with the 1914-17 tax reforms, local direct taxes are collected by the local governments. The local government assemblies set the local tax rates during the budgetary process based on how much revenue is expected from the accrued taxes. However, an important point, specified in the state official tax system documents is as follows: "*However, the rates may not exceed certain limits determined by central government, which are applied to bases also determined centrally*" (The French Tax System 2011), pointing out to low subnational fiscal autonomy or as well low fiscal shared rule, as I also noted in the previous sections. As stated earlier, France did not undergo a substantial fiscal decentralization. As a result of the reforms, regions received several taxes, same as direct taxes – as municipalities and departments and indirect licenses. The revenue decentralization is also closely linked to inequalities. In one interview, an expert claimed the following: "*State transfers in the past were very **favorable** to the local governments, which generated **inequality**. There are small municipalities with a lot of money – who do not want to share this with other governments. The problem was addressed by the reform of July 1999*"[101].

The central government allocates its fiscal transfers to the municipal governments with a set of "independent grant programs" in France. One of the aims is to "*equalize **fiscal capacity** of local governments*" by the unconditional grants (Prud'homme, 2006; Reschovsky 2007). Reschovsky

[101] Personal interview, Paris, France, March 2014.

(2007) explains the allocation of local government grants in France as follows: "*The allocation formulas include measures of tax capacity and a few cost factors. These cost factors are: Population size, number of students, number of public housing units, road mileage and number of vacation homes – appears to have been quite ad hoc*" (p.416).[102]

There are two types of grants for the regional and local levels: a governmental block grant (*dotation globale de fonctionnement*) as well as a decentralization grant, (*dotation generale de la decentralization*). As Cole (2012) states, "*The proportion of state transfers as a percentage of local government revenues has diminished progressively since 1982*", and because of this, subnational authorities had to borrow money or raise local taxes or attract private investment (p.322). One expert had the following view on how equalizing the state transfers are: "*State transfers are applied proportional to the population but there is no pure equalization*"[103].

According to Gilbert and Guengant's (2003) study of French local government grants, distributional politics determine the revenues of local governments rather than a fair econometric analysis on what each local government should get. A study by Fabre (2015) that examines discretionary investment grants received by municipalities in 2004 – 2010 from one upper tier shows that the mayors who hold an office at the district level (25 percent) get twice as much discretionary grants as those who do not. In other words, aligned municipalities are more prone to receiving higher grants, indicating a move away from horizontal equity in France.

[102] Looking at intergovernmental grants for redistributive issues raises some caveats since grants go from a group of people to another and does not always necessarily mean redistribution among individuals (Oates 1972), and it might not actually reach desired redistributive outcomes. However, since it is still closely related to the idea of "reaching horizontal equality" by supplementing the revenues of subnational governments, especially the asymmetries within this system are telling about the nature of fiscal governance.
[103] Personal interview, Paris, France, March 2014.

According to 2006 figures, the central government transfers are responsible for 48 percent of the local government revenue, which are determined by formulas with no conditions – distributed mostly as block grants (Prud'homme 2006). More specifically, there are earmarked and non-earmarked intergovernmental grants in France, which can be both discretionary and non-discretionary.[104] Some of the earmarked grants are mandatory while others are discretionary. Within mandatory grants, some are matching and some are non-matching. **Figures 23** and **24** below show the percentage of earmarked and non-earmarked intergovernmental grants in France between 2000 and 2006, with earmarked grants increasing from 2003 to 2004 and that they are much higher than non-earmarked ones.[105] This also shows a centralizing trend in terms of intergovernmental grant allocation.

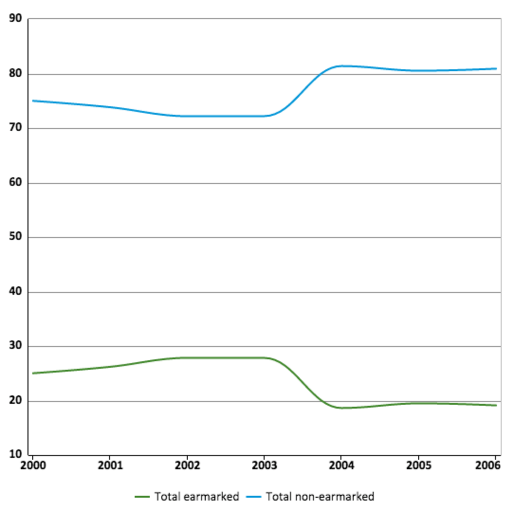

Figure 23. Earmarked and Non-earmarked Grants by Type-Percentage of Total Grants in France

Source: Knoema Data Atlas, OECD

[104] More specifically, there are earmarked and non-earmarked intergovernmental grants in France, which can be both discretionary and non-discretionary. Some of the earmarked grants are mandatory while others are discretionary. Within mandatory grants, some are matching and some are non-matching.
[105] Data for the years after 2006 are not available. Non-earmarked grants are those that could be spent the same as sub-national government's own (non-earmarked) tax revenues.

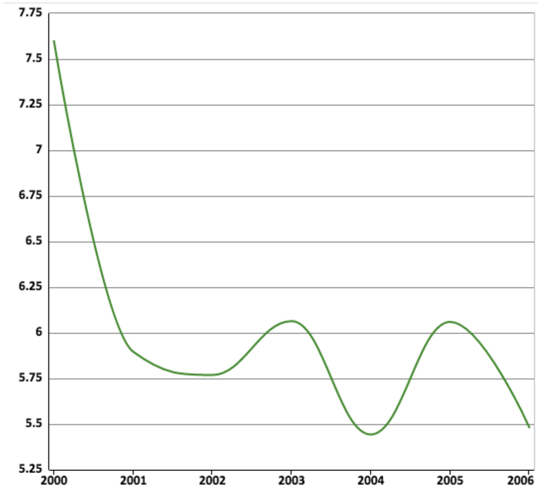

Figure 24. Discretionary (Earmarked) Grants by Type-Percentage of Total Grants in France

Source: Knoema Data Atlas, OECD

Discretionary grants, and the conditions under which they are given, are not determined by rules but decided on an ad hoc, discretionary basis. Discretionary grants are often temporary in nature and include, for example, grants for specific infrastructural projects or emergency aid to a disaster area. There are no non-earmarked discretionary grants, which shows the centralization level of the government's intergovernmental grant policies. Non-earmarked grants are those that have to be spent on a specific purpose.

7.6 INTERACTIVE GOVERNANCE: INTERGOVERNMENTAL INTERACTIONS, SOCIAL ACTORS AND WAGE BARGAINING

"*France has an efficiently mitigated centralization (central power entangled in local issues). You have different interests represented in the parliament to neutralize themselves.*"[106]

France is classified as a centrifugal democracy, which was marked by the absence of agreements and the lack of integration at the elite and mass levels for its Fourth Republic (Peters, Doughtie and McCulloch 1977), and associated with *distributive* rather than *redistributive* policies, unlike Sweden. A factor that contributes to the difference between Sweden and France in this regard, according to Peters et al. (1977), is the "*noncooperation between various elite groups (especially the Communists) which clearly distinguishes this competitive situation from the coalescent behavior of Swedish elites*" (p. 338). This section of the case study on France first examines the intergovernmental aspect of interactive governance, followed by a look at the influence of social actors in policy making in areas that are related to inequality, such as wage bargaining. This discussion will also include an examination of corporatism or lack thereof. I conclude with an index of interactive governance in France.

I classify France as a low interactive governance country, but what really makes it less interactive than another unitary country in the typology of this work, such as Sweden? And how does this matter for issues related to income inequality? The overlap of ambiguous territorial layers, which is a product of the intertwinement of centralization and decentralization, and associated intergovernmental relations are crucial in understanding why France has less

[106] Personal interview, Paris, France, March 2014.

interactive governance. Furthermore, building on the debate on whether France is corporatist / neo-corporatist, in this section I will illustrate that it is not the total absence of social actors but rather the nature of their participation in the policy making process that contributes to non-interactive governance in France. France's pluralist rather than corporatist governance also help explain why France is classified as a low interactive governance country.

7.6.1 Intergovernmental relations: overlapping jurisdictions and duplication of resources in France

As specified in the first section of the chapter, there are many levels in France with similar jurisdictions, causing the duplication of tasks and resources, leading to inefficiencies in welfare state provision. This blend of centralization and decentralization has contributed to the ambiguity of the layers and coordination issues. As Thoenig (2005) explains, France has a blend of democratic and indirectly democratic jurisdictions, which also overlap in different ways, adding to the complexity of the interactions in governance:

"At one end of the spectrum are classic democratic jurisdictions, such as the commune, the département and the region, where citizens elect the officeholders. These bodies have their own administration and raise their revenues directly from taxes. At the other end, France has ad hoc configurations whose raison d'être is to administer a specific function – collection of garbage, economic development, and so on. These are governed by so-called indirect democratic principles. Participation in them is optional, depending on the discretion of local and regional councils" (p. 688 – 689).

Reforms brought by the different waves of the decentralization have not totally eliminated the problem of ambiguous and overlapping jurisdictions, and this issue is closely linked to redistributive problems, which are then associated with inequality. Levy (2001) argues, "*None of these problems can be solved by 'less state'. Rather, what is needed is a different kind of state, an empowering or enabling state: a state that intervenes aggressively to remedy emerging local dysfunction, to adapt local resources to local responsibilities, and to provide incentives for local cooperation rather than conflict*" (p.115). Concerning the overlaps, one interviewed expert has stated, "*Local authorities are expected not to infringe upon respective functions of another authority (to address concerns of the local population) and it depends on their financial capacity as well*".[107] Therefore, the implications of overlapping jurisdictions on the blurring intergovernmental interactions and subnational fiscal capacities are important to explore in the discussion of inequality. On this note, concerning the duplication of resources and recent decentralization reforms, one of the interviewees claimed the following, pointing to attempts to changing the current system that does not function effectively: "*The critique was that everybody is doing the same and there is a waste of money – meeting to agree on co-financing, which indicated that there is an overlap of the competences of different levels. Also, there was criticism from the local councils: for local councilors, having this power to finance everything very difficult to support a municipal initiative, there was a concern to say no. The local politicians were against this clause of general interests. In 2013, there was a removal of this with the new law. Mayors and President of Regions have many mandates and this will be removed with the Organic Law, which will be in effect after the election of 2017.*"[108] In other words, more political decentralization comes with greater responsibility for the subnational units, which local politicians do not always wish to undertake partly due to the difficulty of meeting financial goals.

[107] Personal interview, Paris, France, March 2014.
[108] Personal interview, Paris, France, March 2014.

The strong central government control in France is not always a “given”, according to some experts especially in terms of controlling implementation or performance. Bezes and Le Lidec (2011) argue that, “*While the center did manage in 2009 to impose fiscal constraints over local governments in the context of the financial crisis, it did not succeed in imposing performance control over local authorities*” (p.34). The Jospin government, which was in power between 1997 and 2002, was regarded to have a ‘mixed record’ on decentralization and it can be argued that this did not lead to more interactive governance. Levy (2001) states the following to explain how local authorities were not involved in the making of the fiscal changes, another evidence for less interactive state of governance:

“*Local officials do not trust government to keep its promise. They fear that in hard times, Parisian authorities will be tempted to scale block grants. Second, local authorities see the power of the purse as fundamental to their autonomy: as state transfers supplant local tax revenues, the power of local governments to conduct policy independently of state preferences is diminished correspondingly. Third and perhaps most important, local authorities were angry that they were never* ***consulted*** *on any of the fiscal changes. Following the most recent top-down tax reform, Centre-Right members of the Mauroy Commission resigned in protest, arguing that the government’s actions made mockery of decentralization in general and of the Commission’s work in particular.”* (p. 114).

It is important to note that the large amounts of local taxes that were eliminated with this reform were justified from an “efficiency” and “equity standpoint” because e.g. local property taxes were regressive (Levy 2001, p. 114). So, we can argue that the centralized decision-making power - without much interactive governance - did not create less equitable results, thanks to the strong steering of the central state for equality in that example.

Another important point for understanding interactive governance in France is the fact that the members of the Parliament are allowed to be a municipal councilor or a commune mayor (maximum 3500 inhabitants), but they are not allowed to have more than two local mandates. As

Marcou (2008) states, overlaps in the inter-municipal offices are not regulated which adds to the complexity in governance. Also a highly interactive state is expected to "*create new competencies, capacities, organizational forms, role images and mechanisms for centralized and decentralized coordination*" (Torfing et al. 2012, p. 236). In France, new laws for the reorganization of the territorial structure are visible, and the continuing restructuring would impact the consolidation of mechanisms for both centralized and decentralized coordination. Nevertheless, the General Commission for Equal Territories *(Commissariat général à l'égalité des territoires)* is one platform for solidarity between the territories.[109] The Observatory for Inequalities (*Observatoire des inegalites*), an organization affiliated with this commission, focuses on regional and national inequality issues, informed by the rising inequality figures of the recent years.

The administrative elite – *corps* -, originating from a centrally designed system, has an impact on the public-private sector coordination as well, since they move to the private sector serving in the public sector (Peters 2015). Contractualization is an important method for cooperation between actors at different levels or public and private actors (Le Gales 2006), which does not necessarily detract from interactive governance *per se*, but it can pave the way for differentiation in the country especially if the territorial levels are fluid, as in the example of France.

Looking at the dynamics of decentralization in general is also telling about the interactive governance structure of a country. As Le Gales (2006) states, the contradictory nature of the decentralization reforms in France revealed, maintained and perpetuated the following: "1) the

[109] Commissariat General A L'Egalite des Territories, http://www.cget.gouv.fr/le-cget/missions

slow erosion, adaptation and firm resistance of the old system: communes/departments/Senate, 2) but at the same time, the coming of age of metropolitan and regional governments, 3) reshaping of a state organization, with a progressive retreat from day-to-day management to a more strategic role at the regional level" (p.202). These can all be said to detract from interactive governance in the case of France.

7.6.2 Vertical and horizontal coordination in France

Centrifugalism and the functional overlaps in France complicate the coordination in France as well. Furthermore, due to the semi-presidential system in France, it is a "particular" case of coordination, since there needs to be coordination between the president and the prime minister, as well as the bureaucracy and the ministers (Peters 2015). The decentralization processes also have had important implications for the vertical and horizontal steering and coordination in France. Cole and Pasquier (2013) and Epstein (2005) argue that in the new decentralization period the central state still intervenes in vertical coordination through agencies of territorial management and controlling the expenditures of the local governments. As Hayward and Wright (2002) explain that the attempts to create better coordination of the subnational governments actually created new bodies and de-concentration did not work effectively: "*Repeated efforts to reinforce the 'horizontal' territorial control of the prefects over the 'vertical', functional field services of the ministries have proved ineffective within the departments*." According to Bezes and Le Lidec (2011), decentralization impacted coordination issues as well: "*Decentralization also initially considerably weakened the prefects' and the Interior Ministry's capacities for coordination and control of the state's territorial policies. Between 1992 and 2003, several* *strategic plans were put forward to reorganize ministries* (on a vertical line) *and local units of the state and prefects' activities* (on a horizontal line) (p. 36)". Le Gales (2008) underlines how public policies are prone to fragmentation due to the fact that both the local governments and the bureaucracy create new "*local government and their bureaucracies spend their time designing new strategies and new schemes in order to coordinate fragmented public policies*" (p. 165). On a similar note, Hayward and Wright (2002) argue:

"Repeated efforts to reinforce the 'horizontal', territorial control of the prefects over the 'vertical', functional field services of the ministries have proved ineffective within the departments. The attempts to do through the regions have made very limited impact. This is because of the refusal to choose between the historic department and the modern region, itself motivated partly by a fear of promoting centrifugal regionalism instead of the integration regionalization of central policies and preferences" (p.6).

One can argue that France has taken steps to remedy its weakness of lacking interactive governance, such as the creation of the inter-municipal cooperation bodies (EPCI) and the creation of the *metropoles*, whose economic effects are yet to be seen and evaluated. In the past, even the idea of local government was extraordinary, since local governments always had to be subordinate in the context of a sovereign state (Cole 2012). The prefects of every region's departments come together along with the Ministry of Finance's regional representative and appropriate members of the field services of the Paris ministries in the Economic, Social and Environmental Council, which is a consultative body to give advice to law makers, somewhat similar to the Spanish system. This can be considered as a factor that contributes to more interaction in governance and horizontal coordination in economic issues. In another move towards more interaction in intergovernmental relations, in 2004, there was an attempt to create a

"*National Council for the Evaluation of Local Public Policy*", planned to be chaired by an elected local councilor and to be comprised of mainly of local politicians. It was not going to have the power to impose financial sanctions. However, this did not materialize due to the veto of local elected councilors and the Senate's opposition (Le Lidec 2005; Bezes and Le Lidec 2011).

One main reason of the influence of local authorities is due to the fact that they have their own members present in the Parliament's senatorial college (the concept of "*cumul des mandats*" - double mandate). Therefore, despite the fact that the government has not granted additional fiscal powers to the regions, this notion of multiple mandates creates discriminatory asymmetric results, evidenced in the study of Fabre (2015) mentioned earlier, in terms of the discretionary grants received by the subnational units, as mentioned in the previous section. The constitutional amendments in France are negotiated at the central level, where both the executive and the parliamentary chambers are involved. The power of the local level in the Senate makes decision-making in France more decentralized than would be expected in a unitary system, despite the fact that welfare state matters are centralized (Le Lidec 2011; Petersohn 2013). In the words of an interviewed expert, "*The Senate is made up of elected not directly by people but by a college of grand electors most of which were municipal councilors. The purpose is to mitigate the centralization.*"[110] Again, since local authorities have their own members present in the senatorial college, with *cumul des mandats*, local authorities do not want to accept any form of central control, and accept only the results of the elections. This clearly demonstrates the gap that separates practices of central control over local authorities in France from those in the UK

[110] Personal interview, Paris, France, March 2014.

(Bezes and Le Lidec 2011; James and John 2007). For example, the local authorities cannot refer legislation to the Constitutional Council by themselves, but members of the Parliament are allowed to do that, and the fact that a big majority of them are locally elected create an indirect regional governance and authority in this regard (Marcou 2008).

The discussions in the Senate concerning the territorial reforms are informative in understanding the bargaining patterns and help explain the interactive governance level. The recent adoption of the *Law on the Territorial Organization of the Republic* witnessed heated debates in the Senate between representatives of different levels - *the representatives of the departments and the regions, as well as Senators*. An analysis of the rhetoric of the Senate minutes on Territorial Reform is informative in understanding the bargaining between representatives of different layers and how that had a bearing on a bill related to inequality, as well as the role of some non-governmental actors. The bill was adopted in January 2015 in the Assembly and on July 16, 2015 in the French Senate. As the minutes of the discussions in the Senate show, the bill was presented as a "compromise" between different territorial layers, and foresees further and gradual decentralization. As a Senator from the Socialist Party expressed in the discussions in the Senate: "*The amendment proposed by the Government is a good compromise, which has preserved the essence of the spirit of the project by providing, after a transitional period, the transfer in 2021 of the overall economic taxation in the metropolis, to enable it for delivery to the expectations of the people, particularly in housing*".[111] Especially, housing has emerged as one of the most important issues in this debate, and as stated earlier, housing policy is an important one for influencing inequality in a significant way.

[111] Translated from French, Senat, Journel Officiel de la Republique France, Session of July 16, 2015.

If we look at the roles of the social actors in this process, an important point was the fact that the Assembly of the Departments of France (*L'Assemblée des départements de France*-ADF), which represents the departments with the public authorities, voted unanimously a motion against the local government reform on July 2, 2014 following the Parliament's passing of the reform laws. The fact that the territorial reforms with recentralizing elements go against what the ADF promotes is informative about the state of interactive governance – or lack thereof- in France. ADF states that they will support more "*decentralization and strengthening of the capacity to act in favor of the territories of human and regional solidarity, while 92 percent of French people trust local authorities to improve their daily lives*".[112] In this statement, ADF emphasizes that local governments do not have enough revenues for public investment in France, and they are also working on influencing the policies for further transfers of competencies to the regions and the departments. For example, within the process of the *Modernization of Territorial Public Action* law – the consultative body of the "National Territorial Dialogue" was formed. Furthermore during the last decentralization reforms, the Ministry of Interior started a consultation process with elected local politicians and interest groups but it is argued that their impact was limited in the actual law making, and also mattered in terms of implementation (Petersohn 2013, p. 306).

[112] An appeal has been made at the Constitutional Council by sixty MPs on this act.

7.6.3 France and corporatism?: the roles of social actors in interactive governance

"*The French economy, while already an advanced capitalist system, lacks the strong associations of employers and labor that are necessary to sustain a high-skill equilibrium*" (Culpepper 2001, p.3).

In France, as a result of the highly centralized political system and a strong executive under the Fifth Republic, the roles of nongovernmental political or labor organizations gradually decreased. Wilson (1987) argues that the French system is "*simply better insulated from the pressures of immediate public opinion*" than many other Western European countries as well as from the "*worrisome parliamentary inquiry of censure* (p. 524). Wilson contends that France is better explained as a pluralistic model rather than a corporatist or a neo-corporatist one. The fact that France is a pluralist system and not yet quite an "interactive" one, can also detract from the coordination capacities of the state. As Thoenig (2005) states, "*French decentralization and modernization policies have stopped halfway between centralization and disjointed pluralism models… Even the prefect, supposed to be the ultimate incarnation of state authority and the carrier of general interest in each region and département, can barely coordinate events*" (p. 689). While corporatism does not necessarily always denote interactive governance, the way the social actors are institutionally embedded in the policy-making mechanism has more similarities to interactive governance than pluralism, which seems to be missing in the case of France.[113] In the interactive governance paradigm, the interactive policy process is related to a corporatist

[113] As Torfing et al. (2012) explain, the question of how certain interest groups have privileged access and contribution to policy making, using the Schmitter (1974) definitions has shifted more towards how interest groups can contribute to public value through interactions. Thus, looking at whether France is corporatist or not provides a good starting point in understanding whether interest groups are influential in wage bargaining or bargaining in social policies that matter.

policy-making structure especially because of its contribution to easier implementation of policies. While we cannot argue that corporatism is necessarily the most interactive form of governance, the way that the interest groups have more institutionalized links to the policy making makes it closer to an interactive governance structure.

According to Wilson (1983), one of the main reasons for France to be classified as a pluralist system instead of a corporatist one is as follows: "*Because of loyalty to their syndicalist traditions and the sharp rivalries among them, French unions are unwilling to engage in corporatist practices. Nor does the Socialist government, like preceding conservative governments seem disposed to grant any of its authority to trade unions or other interest groups*" (p. 908). Wilson (1987) attributes the following reasons why the system is plural: there is no single group speaking for a specific interest sector, the groups are unlimited and competitive, they cut across sectors without rigid categories, with voluntary memberships. The fact that they are not hierarchically ordered would not necessarily detract from interactive governance, but their lack of unity would. Furthermore, he claims that the fact that the Fifth Republic was built upon the remains of instability caused by "sectarian interests" insulated the state and the politicians from special interests. Based on the interviews and the literature, the case of France does not reveal enough evidence for the "*continuous dialogue between politicians, bureaucrats and societal actors*" as expected from an interactive model (Bang 2007; Torfing et al. 2012) and shows that the central state has managed its redistributive policies without a lot of input from social actors. Interactive governance also focuses on the horizontal aspect of governance where policy makers and targets are blurred (Torfing et al. 2012), which we do not find to a significant extent in the case of France.

Unlike Sweden, France has five confederations of labor organizations that are recognized by the states as partners, and there is no umbrella organization such as the Swedish LO or the German DGB (Hall and Keeler 2001). The biggest confederation is the General Confederation of Labor (CGT - *Confédération générale du travail*), which used to be affiliated with the Communist Party. The second largest union organization is the French Democratic Labor Confederation (CFDT – *Confederation Francaise Democratique du Travail*), mainly affiliated with the Socialist Party, especially in the past (Ibid 2001). The majority of workers and managers are not organized members of those groups, which detracts from its interactive governance nature. According to Compston's (2003) classification, France is "a *narrow-concertation country with sporadic concertation*". In the 1940s, a tripartite system was envisaged with the Economic and Social Council, which did not materialize as a platform for policy concertation, mainly due to the fact that there was no real "*shared economic understanding between governments, employers and unions*" (Compston 2003, p. 799).

As Atkinson (2015) notes, it is difficult to encapsulate the bargaining strength of unions in quantitative indicators, and wage-setting centralization is an important indicator. Despite the overall centralization of the country, the unionization level in France is argued to be weak, as a clear opposite of Sweden and also marked by divides between "insiders and outsiders" (Davidsson and Emmenegger 2012). The policy area coverage of the influence of unions in France is limited to "employment law and social security" (Compston 2003). Therefore, it is not only the weak unionization but also the policy area coverage that contributes to less interactive governance.

The non-inclusiveness or the limited roles of the unions in the policy-making are also evident in the quantitative indices. If we look at France's wage bargaining scores in the "Data

Base on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts, 1960-2014" (Visser 2015; Kenworthy 2001), we can also observe a change in the coordination of wage-setting procedures after 1960. In 1960, the score was 4, which indicated that there was a) centralized bargaining by peak associations with or without government involvement, b) informal centralization of industry-level bargaining by a powerful and monopolistic union confederation, c) extensive, regularized pattern setting coupled with high degree of union concentration. However as of 1961 until 2014, the score is 2, which corresponds to "mixed industry and firm-level bargaining, with no or little pattern bargaining and relatively weak elements of government coordination through the setting of minimum wage or wage indexation". In their roles concerning pensions, training and union rights, the unions in France get a score of 0.

The administrative role of the unions for the workers can be regarded more important than their inclusion in the policy making (Palier 2012). "*Unions played important roles through their participation in the deliberation and administration of policy*" (Davisson and Emmenegger 2012, p. 210). In both France and Sweden, public legislation bestows upon the unions the important role in the administration of lay-offs, which allows unions to defend the compensation of workers in the form of redundancy pay and training measures, and to protect union delegates against dismissals. In France, union delegates have the right to be informed and consulted by the employers, including the establishment of social plans in the case of collective dismissals for economic reasons. As Palier (2012) states, unions have the right to question the social plan by inviting an external accountant. The public administration (DIRECTTE – "*The regional departments of companies, competition, consumption, labor and employment*") then forms its decision regarding the social plan on the basis of all existing information (p.212).

Within the decentralization process, the role of unions in the policy making process went through some changes. As Davidson and Emmenegger (2012) explain, the decentralization process of the 1970s gave the role of deciding over the economic decisions of the firms from the state's labor inspectors to the judges, who were considered more neutral and the juridical process was more inclusive of the unions. The power of trade unions is closely related to the dualization process of insiders and outsiders, which is linked with rising inequality. In 1979, an agreement was reached between the government and the social partners. Until that point the social partners managed unemployment insurance by negotiating national level collective agreements, as mentioned earlier, starting with the 1958 reforms (Compston 2003). After that point, the contributions were financed by the social partners and a state subsidy, but the social partners would be managing the system. In 1982, there was a deadlock in the system concerning how to manage the unemployment benefits and in 1984 there was a tripartite agreement. Therefore we see a direct influence of unions that actually transformed to a more indirect influence. Despite the low-interactive nature of governance compared to Sweden, unions have found another platform through which they can voice their concerns. The law passed on July 25, 1985 softened the regulation on temporary work, and with the coming to power of a conservative government, the inclusion of unions actually lessened (Palier 2012). France saw the strengthening of job security for regular workers and a limited re-regulation of job security for temporary workers. Legislation ensures the exemption of union delegates from collective dismissals.

An important point to reiterate is that, in the argument of this dissertation, when investigating the role of social actors and their importance in matters related to inequality, I assume that unions (as one unitary actor) would ask bargain with the state for wages (or policies) that favor most of the worker population as a whole and will ask for a protection for both insiders and outsiders. For example, during the process of passing the pension reforms in the Sarkozy presidency concerning the special working regimes for workers in different sectors, the unions, and especially the members of the CGT were divided. CFDT did not want to oppose the reforms. During the negotiations on job security legislation, the employers wanted to create a new type of fixed term contract during the Sarkozy period – 2008 reforms - but the unions were critical in asking for more compensatory damages. Therefore, one important element that distinguishes the French unions from Swedish unions – an interactive governance system - is that their role in wage bargaining is limited, while they have a strong role in the protection of the interests of the workers as guarantors. As Goldhammer (2013) argues, "*despite innumerable consultations with societal actors, the initiative for reform, and the general philosophy that shaped its provisions, remained with the state*" (p. 141). Therefore, we can see there are dualist reform patterns in France – with new legislation fitting union demands. Therefore the non-interactive category of France can also be explained by the dualization of benefits: Job security for regular workers remained in place and unions' interests were observed, but protection for temporary workers has been deregulated and they had to adjust to economic pressures by introducing more flexibility. As Van Kersbergen and Vis (2014) explain this high dualization of the insider-outsider structure translates to high youth unemployment, circa 2007, which also correlates with the rise in inequality as of 2010 and a possible increase in the near future. Obviously, it is hard to attribute causation to correlation, however, further dualization of the economy can pave the way for higher inequality.[114]

[114] Meanwhile, The main employers' union (CNPF – which transitioned to MEDEF in 1998) aimed to create more labor market flexibility. According to one of the CFDT negotiators, the reason was their desire to create a larger space for the social partners in the area of labor market form. The idea was to institutionalize cooperation on the political and workplace level with a joint management, which has not totally materialized.

7.6.4 Summary of interactive governance in France and the Interactive Governance Index

In sum, the low-interactive level of France is not high enough to offset the national equality principles. However, the fact that it is a less interactive state due to the lack of a unified voice of wage bargaining by the societal actors and the complex intergovernmental relations might have created, and continue to create a suitable environment for higher inequality to flourish at a time when market incomes are also becoming more unequal. More importantly, the *etatiste* nature of the system tends to prevent effective interactive governance. Less interactive governance also enables, or at least does not prevent, more regional inequality and territorial differences, which in the long run can translate to higher overall inequality. The insider / outsider divide that feeds from the pluralist system also might be a contributing factor for more inequality. It is a more pluralist system in terms of the centrality of the actors rather than a corporatist system. Some characteristics that lead to less interactive governance in France are:

- No fiscal control of the subnational units
- Overlapping and complex jurisdictions that are being transformed and detracts from the specificity of responsibilities for different layers – making it harder to identify goals
- Senate works at the expense of urban areas and represents rural interests more than the urban areas
- EPCI are not directly elected
- Three decades of layering attempts – no final word, which detracts from the ability of the territorial layers to agree on common goals
- Regions (most of them) do not have identities
- Overlap in offices: Overlap in inter-municipal offices is not regulated
- The balance between urban & rural regions is not always clear
- No direct involvement of social actors in the policy making process, in policies concerning wage bargaining

- Union representation is not wide, narrow/weak policy concertation

Overall, France is a medium-low interactive governance state. Despite these factors that lead to less interactions in governance that “matter” for inequality – such as lack of shared rule in general – and the lack of shared fiscal rule - , France’s centrally designed redistributive policies have been key in maintaining a generally standardized welfare state throughout the nation. Furthermore, there has not been very substantial fiscal decentralization – which I argue, could have increased inequality, despite the fact taxation is found to be the culprit of rising inequality. On the other hand, reforms on the territorial structure, e.g. merging of different layers and the creation of *metropoles*, come with different platforms, which can enhance horizontal coordination and interactive governance. Whether the reforms will increase the income gap and the welfare state provision discrepancies between the *metropoles* and the other areas, or whether they will lead to more efficient and standardized welfare state provision remains to be seen, during these times of increasing income inequality in France. Overall, connecting the French case to the theory of the dissertation, the centralized nature of the territorial governance structure is significantly related to France’s lower income inequality nation status in Europe with its centralized and unitary system, despite the increases in the recent years. Below is the table that showcases the Interactive Governance Index of France on welfare state related matters.

Table 15. Interactive Governance Index of France

Processes	0 Low	1 Medium	2 High
Identifiable goals – concerning equality in tax capacities and social policy delivery		X Political culture to 'egalitarianism'	
Reliance of subnational units on the central government reliance for tax coordination			X
Vertical: Clear and observed rules of relationships between each subnational government and the central government	X Overlapping jurisdictions	X Certain overlaps in the territorial governance structure Mergers vs. more decentralization – happening at the same times with some uncertainties for the future	
Vertical interactions (mutual contingencies and interdependencies between different levels)		X Decentralized implementation and service delivery for some policies	
Horizontal interactions: Central government's capacity to coordinate among its departments & interactions among different layers		X	
Relying on social partners and compromise and centralization of wage bargaining	X		
Harmonized and integrated policies at various levels		X	
Outputs			
General goal attainment and distributional effects		X	
Institutionalization and dissemination of revenues with equalizing effects		X Intergovernmental grants creating regional differences	
Systemic approaches to governing at different levels		X Vertical and horizontal coordination mechanisms and capacities improved	

8.0 CASE OF SWEDEN: A UNITARY AND DECENTRALIZED COUNTRY WITH INTERACTIVE GOVERNANCE

"Sweden is a unitary state: Power, influence and voice are diffused through ***many levels"***.[115]

I classify Sweden as a unitary state with high interactive governance in the typology of the dissertation. According to the quote above from the interviewed expert, many (territorial) levels and channels are utilized in this unitary state to diffuse power, influence and voice. The following paradox in Sweden is important: It is a consensual political system but it is still able to produce significant levels of redistribution rather than the more distributive policies that would be expected from its governance structure. Sweden has a strong central government that governs as a whole rather than through different ministries and the government agencies are independent of the cabinet, with representatives of different interests (Öberg 2016). Sweden's general characteristics are significant in applying the theory of the dissertation on decentralization and inequality: The prevalence of social democracy, the long-standing compromise between labor and capital, and a comprehensive welfare state (Rothstein 2016). Along with the importance of the territorial governance structure, these characteristics of Sweden provide an important foundation of our understanding of the Swedish case in general and its comparatively low inequality levels in Europe. Furthermore, the recent changes to these characteristics also need

[115] Personal interview, Gothenburg, Sweden, March 2013.

emphasis in the analysis, as they shed light on increasing income inequality in Sweden, despite its continuing categorization as a low inequality country in Western Europe and in the world.

To understand the impact of the territorial governance structure and its interactive governance levels on inequality, this case study on Sweden examines, 1) a) the official sharing of competences in Sweden: how Sweden is an example of unitary and a decentralized country at the same time, and b) the decentralization, recentralization and regionalization processes over the years, including the influence of the EU regional policies[116], 2) the recent income inequality trends in Sweden, 3) the evolution of the welfare state, including the fiscal policies, and some social policies that have an important bearing on inequality, 4) the **interactive governance** index of Sweden: What features make Sweden a highly interactive governance country? This chapter makes use of elite interviews in Gothenburg, Sweden, in the region of *Västra Götaland*, as well as primary and secondary sources, such as official statements, legal texts and extant literature.

As stated earlier, the main goal of the case studies is to apply the theory that political, administrative and fiscal decentralization, and the interactive governance levels of a country have significant impacts on its income inequality. I do this by examining cases that vary in terms of their decentralization and interactive governance levels. Sweden is a unitary and a highly decentralized country with strong central coordination mechanisms and high interactive governance levels, which contribute to its categorization as one of the most equal OECD countries. This case study aims to demonstrate the causal mechanisms that lead to lower inequality levels of Sweden and the recent phenomena that contribute to the increases in income inequality. In this work, Sweden's classification as an interactive governance country is largely

[116] Interviews have been conducted in March 2013 with *Vastra Götaland* regional officials and other experts in the city of Gothenburg, which is located in the region of *Vastra Götaland*.

due to the nature of its intergovernmental relations, its corporatist structure, and the inclusion of the social actors in wage bargaining and policy making in matters that have a bearing on inequality.

8.1 GOVERNMENTAL LEVELS IN A UNITARY AND DECENTRALIZED SYSTEM IN SWEDEN

"All public power in Sweden proceeds from the people. Swedish democracy is founded on the free formation of opinion and on universal and equal suffrage. It shall be realized through a representative and parliamentary polity and through local self-government. Public power shall be exercised under the law" (Chapter 1, Article 1, Instrument of Government).[117]

Sweden is classified as a unitary state with interactive governance, and one that is also highly decentralized. It might seem contradictory at first glance that Sweden has a unitary state, with principles of equality of services, and at the same time local governments with strong resources and fiscal authority. Yet, this is also a characteristic of the Nordic welfare state model where the strong central government steering requires strong subnational units for delivery of its services (Lidström 2016). Sweden is a parliamentary monarchy, and the one chamber parliament, (since 1971) *Riksdag*, represents the people. The Prime Minister leads the government, but the head of state is officially the Monarch. The Swedish Constitution promotes equality for all peoples of Sweden and also emphasizes the promotion of rights for the native

[117] The Instrument of Government, http://www.riksdagen.se/en/How-the-Riksdag-works/Democracy/The-Constitution/The-Instrument-of-Government/

Sami people and all the minorities[118]. The importance of local autonomy stems from the Constitution's provisions by which local institutions are protected from "impositions by central government" (Pierre 2016). The matters of foreign affairs and defense rest solely with the central government, whereas matters such as public health, culture or transport are the competences of the local governments.[119] Local self-government is one of the "*cornerstones of Swedish democracy*" (Larsson and Båck 2008, p.11). The actual implementation of self-government is not laid out in the Constitution, however, and this gives the Parliament the right to change the powers of local or regional governments (Feltenius 2007). Nevertheless, there is an administrative independence for all the levels, implying the importance of local governments for implementation of public policies:

"No public authority, including the Riksdag, or decision-making body of any local authority, may determine how an administrative authority shall decide in a particular case relating to the exercise of public authority vis-à-vis an individual or a local authority, or relating to the application of law" (Chapter 12, Article 2 of the Instrument of Government).

Sweden became a "coherent state" around 1523 after the dissolution of the Kalmar Union, which was made up of Sweden, Denmark and Norway (Lidström 2011). Sweden's unitary characteristics go back to this date when different county laws were replaced with central rule. As Lidström (2011) explains, the monarchs used the central government to their advantage, and as of the 19th century, the centralized state was used as a tool to establish a 'unified welfare state' and a 'consensual' state. Furthermore, Sweden has been described as a 'centripetal state' with a relatively homogeneous political culture and active competition for public office (Peters et

[118] Ibid.
[119] European Union, Committee of Regions, https://portal.cor.europa.eu/divisionpowers/countries/MembersNLP/Sweden/Pages/default.aspx

al. 1977). It has also been referred to as a 'decentralized unitary state' by Loughlin (2006), Ansell and Gingrich (2003), Lijphart (2012) and Biela et al. (2013).

According to Loughlin and Peters (1997), Sweden exemplifies the Scandinavian state with a strong central government and significant local autonomy with a "consensus based" decision-making process. Peters et al. (1977) classify Sweden as a "depoliticized political system" with high levels of redistribution from the public budget[120]:

"*The term depoliticized would appear inappropriate for a nation with such an active political life, but in the term's limited meaning of relatively restrained political discourse and a high level of cooperation and compromise in decision making, it would appear quite fitting. In fact, the standard description of Swedish politics has been that of compromise and the "depoliticization" of potentially divisive issues*" (p. 336).

This concept of a "depoliticized" Sweden with high levels of cooperation and compromise in decision-making also has important implications for the interactive governance of Sweden, as this chapter will demonstrate.

Sweden has a unitary constitution with a "multi-tiered government" (Shah 2007). There are three levels of government; which are the **central** (national) level, the **regional** level and the **local** (municipal) level, with no hierarchical relationship with one another[121]. The term local government consists of municipalities and county councils.

The **regional** level is made of **counties** (*län*) and the – almost - overlapping 21 elected **county councils** *(landstinge)* with foundations dating back to 1634 (Larsson and Båck 2008).

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[120] I will elaborate on the issue of redistribution in the section on the Swedish welfare state.
[121] The Swedish Model of Government Administration, http://www.government.se/how-sweden-is-governed/the-swedish-model-of-government-administration/

County councils *(landstinge)* were represented as institutions in the upper chamber until 1971, with members elected proportionally elected based on population for six years (Hooghe et al. 2010). The powers of both chambers were equal. In 1971 Sweden became a unicameral state with *Riksdag* currently remaining as the only legislative chamber. Parliamentary elections and municipal and county council elections take place every four years on the same day, and seats are distributed according to a party-list proportional representation system. The main role of the county councils is to coordinate policies that are too broad to be administered by municipalities, such as health care, public dental care and disabled care – constituting about 90 percent of their budget – as well as regional development (Montin 2016); and the county councils can levy their own income taxes.

There are also two **regions** with a different status, *Skåne* (Scania) and *Västra* (West) *Götaland*[122]. In *Skåne* and *Västra Götaland*, the newly established county councils took up some of the tasks of the central state on regional planning and regional development, indicating a move towards more regionalization (Larsson and Båck 2008)[123]. There is no hierarchical relationship between the counties/regions and the local level (Lidström 2011).

Government bodies exist in form of de-concentrated **county administrative boards** (*länsstyrleser*), which are considered to be prefecture-like agencies (Niklasson 2016) rather than regional authorities, as they are regulated directly by the government. These boards were regarded as "the extended arm of the king" in the past and they controlled the government policies in the region, whereas now they share tasks of implementing EU's structural funds and

[122] *Västra* (West) *Götaland* is the result of a merger of three county councils in West Sweden and the city of Gothenburg. *Skåne* is made up of two county councils and the city of Malmö. There is also the island of Gotland as a municipality with functions of county council.

[123] Whether these regions will take up different policies than the rest of the country is an important point to analyze in the near future.

transposing the sectoral policies for the development of the territories (Hanssen, Nergaard, Pierre and Skaalholt 2011). Therefore, there is a dual regional government structure with "parallel administrations" in the form of **county councils** and **state county administrative boards** (Hooghe et al. 2010). This parallel administration can be regarded as a type of **shared-rule** between the central and the local government, yet the following remains as a concern for the balance between **shared** and **self-rule**: "*There has been a long-lasting discussion of how to integrate the top-down nature of the state administration with the region's own system of democratic representation*" (Hanssen et al. 2011, p.42).

At the local level, the 290 **municipalities** (*kommuner),* with their elected council or assemblies, constitute the local government level in Sweden. Municipalities have the tasks of taking care of the water supply, roads, transport, environment, housing, elderly and child-care, cultural and recreational policies, as well as public welfare (Larsson and Båck 2008). They can also levy income taxes. As emphasized on the Swedish government's official website, all municipalities should provide the minimum of level of basic services regardless of their resources: "*…Municipalities have significant latitude in deciding what services they should offer. They are however legally obliged to provide certain basic services*" [124]. According to the Local Government Act (1991):

"*Municipalities and county councils may themselves attend to matters of general concern which are connected with the area of municipality of county council or with their*

[124] The Swedish System of Government, Local and Regional Administration, https://sweden.se/society/the-swedish-system-of-government/

members and which are not to be attended to solely by the state, another municipality, another county council or some other body" (Chapter 2, Section 1).[125]

The abovementioned Swedish Local Government Act *(Kommunallagen)* is the main document from which local governments derive their official rights, which emphasizes that local governments can take up activities that concern their own territory with significant leverage on what services they can provide, indicating the decentralized and the localized nature of governance.

The task allocation between different local authorities is showcased in the typology of Larsson and Båck (2008), shown below. In this typology, the most important subnational public organizations in Box 1 are the **central government generalist agencies** with many tasks but low representativeness, which are the **county administrative boards** (*länsstyrelser*). As mentioned before, county administrative boards are considered as the "intermediate level" which are central government units with regional development responsibilities outside the two regions of *Skåne* and *Västra Götaland.* The local self-government bodies in Box 2, which are the **county councils** and **the municipalities**, have high representativeness with many tasks. The **central government agencies** and **specialist agencies**, on the other hand, have low representativeness and many tasks. This typology shows that there is considerable difference between the representativeness level of local governments and the central government generalist agencies, but both have many tasks in service delivery, showing the diversity of task allocation.

[125] The Swedish Local Government Act, http://www.government.se/contentassets/9577b5121e2f4984ac65ef97ee79f012/the-swedish-local-government-act

Table 16. Task Allocation and Representativeness of Units in Sweden

	Low representativeness	High representativeness
Several tasks	1- Central government generalist agencies (county administrative boards - *länsstyrelser*)	2- Local self-government bodies (municipalities and county councils)
Few tasks	3- Central government specialist agencies	4- Special districts (no examples exist in Sweden currently)

Source: Taken from Larsson and Båck (2008), p. 210.

8.2 DECENTRALIZATION, RECENTRALIZATION AND REGIONALIZATION PROCESSES IN SWEDEN

"*Local self-government is a longstanding tradition in Sweden and of fundamental constitutional significance. The principle of local self-government has been enshrined in the Constitution as an integral part of democratic government in Sweden*" (The Swedish Local Government Act 1991).

Sweden is a decentralized country especially in terms of how policies and services are implemented. Broadly speaking, the decentralization process in Sweden has been ongoing since the 1970s (Feltenius 2016). Like other countries examined in this work, Sweden also has been going through decentralization and regionalization processes, yet it has also experienced recentralization in some fields such as health care or due to politicization of its government offices (Dahlström and Pierre 2011). The trade-off between local self-government and national equality is an important tension that is recognized and addressed in the territorial governance structure and the decentralization process. In line with the theory of this work, on this topic, Montin (2016) argues: "*More specifically, one the one hand people should have equal access to high quality of services independent of where they live. On the other hand, political priorities should make a difference and service production should be adapted to local needs*" (p. 368).

The centralized nature of governance in Sweden and its key role for shaping the welfare state has historical roots. After the creation of the Swedish state in 1523, the king used local bailiffs and regional governors who were in charge of taxing the peasants and organizing the soldiers, which provided resources for the expansionist wars (Lindkvist and Sjöberg 2006; Lidström 2011). The unitary features have served the monarchs and the conservative rulers for maintaining "national identity". During the 20th century, the Social Democrat governments utilized these unitary characteristics to maintain the "unified welfare state" (Lidström 2011). Therefore, the fact that there have not been very serious regionalization protests against this unitary character of the state, and that having a unitary state was to the benefit of those in power in different time periods, enabled the simultaneous flourishing of the centralized nature of the state and the strong local governments.

The current decentralized territorial governance structure of Sweden is traceable to the local government ordinances of 1862 that established the county councils. Starting from the 1960s, the subnational units have gained more powers – especially in terms of their (self-rule) financial authority. In 1952 and 1974, two reform processes merged some of the local authorities, and therefore the number of municipalities were decreased and municipalities with larger sizes were created; leading to some contestations and further divisions in 1976 (Larsson and Båck 2008; Lidström 2011).

In fact, the processes in Sweden that led to reorganizations of central and local authorities have largely been more *task* and *outcome* oriented rather than having strictly centralizing or decentralizing tendencies for political or ideological purposes (Larsson and Båck 2008). As Montin (1993) states, the central – local government relations are a matter of a practical question. Montin refers to the State Commission Reports of 1974, where it is stated that "*advantages and disadvantages of centralized and decentralized administration often have to decide the matter*" (p. 30). Nevertheless, task oriented central steering is still a political choice. Lindvall and Rothstein (2006) explain the creation of the "politically induced social steering" of welfare policy in Sweden by explaining the two different periods in which it occurred. The first period was marked by an emphasis on central government's civil service departments, including the Board of Education, Housing, Health and Welfare and the Labor Market Board. In the 1960s larger municipal units were established in Sweden to execute the principle of "self-government". As Lindvall and Rothstein (2006) state:

"*The two administrative systems attempted to reconcile the classic conflict between* ***local autonomy*** *and demands for* ***nationwide equality****. Via their advisory boards, inspections and regulations, the central civil service departments stood for the idea of a nationwide, common standardization of policy, while the municipalities adapted programs to local conditions"* (p. 50).

The amalgamation of the municipalities made them resourceful institutions to provide welfare policies (Montin 2016). While this amalgamation pointed to more centralization, this also prompted a wave of decentralization in the latter years of the 1970s and 1980s, which can be characterized as deregulation and also "administrative modernization" (De Vries 2000; Naschold 1996; Montin 2016). As De Vries (2000) explains, the decentralization tendencies aimed at countering the "*overregulation by the central state*" (p. 210). During this period, Sweden tested the idea of '*free communes'* (CFE), whereby some counties applied for dispensing the state laws. However by the second half of the 1980s, local governments did not have many options to increase local taxes anymore (De Vries 2000). Despite the fact that only a few of the dispensation applications were approved by the central government, this experiment is regarded as an important symbol of attempts to increase 'local discretion', and it paved the way for similar motions in other Scandinavian countries (Larsson and Båck 2008).

In Sweden, the move towards establishing bigger units for better service delivery and more effective welfare state can be considered as a move away from decentralization and a move towards concentration, as well as regionalization. In 1997, the two **regions** of *Skåne* and *Västra Götaland* were created through merging of the counties.[126] As Larsson and Båck (2008) explain, the collection of local government performance measures is an indication of centralization:

"*The picture that has hitherto been painted is one of extensive local freedom of action and self-government. However, the fact is that many features, both in the present debate and in policy-making, pull in the centralizing direction… There is a growing apparatus for collecting performance measures*" (p. 216).

However, another view is that the ongoing decentralization also contributed to the weakening of the central state. It also might have led to the flourishing of the idea that centralized planning might not be necessary, manifested by the closing of the National Board of Urban Planning in 1986 and the National Board of Education in 1991 and the opening of other agencies that do not resemble them (Lindvall and Rothstein 2006). However, one can argue that this has also paved the way for more interactive governance and coordination, rather than central

[126] Västra Götaland was created with the merging of Göteborg and Bohus, Alvsborg and Skaraborg, whereas Skåne was created with the merging of Kristianstad and Malmöhus.

governmental dominance, in line with the idea of "from government to governance" (Pierre and Peters 2000). As Lindvall and Rothstein (2006) argue, the new administrative bodies mainly aimed to coordinate public, semi-public and private projects, which were outside the governmental or the *Riksdag* influence (Rothstein 2005; Lindvall and Rothstein 2006).

The regionalization reforms of Sweden have been going on for several years, and they have implications especially concerning the welfare state policies and regional development. For example, the experimental regional reform, implemented in *Skåne, Västra Götaland, Kalmar and Gotland* aimed at strengthening the elected regional parliaments rather than the county boards, with no-strings attached state grants. As Hanssen et al. (2011) explain, this paved the way for variances in regional development, but the interests of the regions were also observed at the same time:

"*The reform clearly signaled relaxed central control over the regions and a strong effort to help build regional governance. It was a logical extension of the policy change in the late 1980s to, indirectly, allow for* ***greater uneven development of different regions****. In the reform, widespread deliberation was initiated with all concerned interests in the region with the objective of producing a program for regional economic development, the so-called 'growth agreements' (tillväxtavtal), to coordinate instruments at regional and national levels*" (p. 43).

In 2003, the Committee on Public Sector Responsibility discussed the comprehensive regionalization reform, which would implement the same regionalization that had been executed in *Västra Götaland* and *Skåne* (Larsson and Båck 2008; Stegmann McCallion and Tallberg 2008).

In *Västra Götaland* and *Skåne*, the tasks that normally belong to the central state, such as regional development and regional policy, were devolved from the county administrative boards to the county councils, and this contributed to the lessening of the overall representativeness of the administrative boards. As one of the interviewees claimed:

"*The local governments have a larger role in providing many services than the regions, but (in these places) regions remain as the main actors in applying the EU's regional policies. Furthermore, some reshuffling of roles has taken place along these merges and regional cooperation bodies*".[127]

The organization of territorial layers in Sweden is going through transformations, indicating that there is a movement for determining how to reconcile the decentralized structure in the unitary state. More powers have been given to regional governments, while they were also granted with the task of coordinating central government agencies by collaborating with one another, so that they have a strong role in economic development (Niklasson 2016). As a result of quests and bills passed in the Parliament, to better connect the regional development initiatives with the national growth strategy, there are now 14 Regional Development Councils. As Stegmann McCallion and Tallberg (2008) state, this added to the "hourglass" territorial governance structure in Sweden[128]:

"*As demonstrated currently in Sweden one can see a differentiated regional level; different kinds of actors in each region, having the same responsibility depending on what type of region it is, i.e. 'old region', Regional Development Council, or Regional Assembly, thus actually adding to the regional mess*" (p. 11).

A clear understanding of the simultaneous processes of centralization, decentralization and regionalization is important in assessing the role of the territorial governance on inequality

[127] Personal interview, Gothenburg, Sweden, March 2013.
[128] Indeed, this is related to the delicate balance between centralization and regionalization in Sweden.

in order to apply the theory of this dissertation. To this end, and in light of the regional development discussion, I now turn to how the European Union (EU) membership impacted regionalization in Sweden.

8.2.1 Regionalization of Sweden and the European Union funds

Sweden's entry to the EU in 1995 also impacted the regionalization process of the country, with the eligibility to receive structural funds within the EU's Cohesion Policy framework (Olsson and Aström 2003). Feltenius (2007) summarizes how decentralization, centralization and regionalization can coexist in the framework of the EU membership in this statement:

"*Centralization measures in Sweden during the period (1990s) investigated can be explained mainly by the importance played by the principle of equality in welfare provision and that decentralization can be explained by the discussions on the 'Europe of the Regions'* (p. 457).

The most important EU Cohesion Policy instruments in Sweden are the European Regional Development Fund (ERDF), the European Social Fund (ESF) and European Territorial Cooperation (collaborative projects between national, regional and local actors of different member states). In addition to that, the European Maritime and Fisheries Fund (EMFF) provides funds for development of sustainable fishing.

The ESF, which is distributed to the whole Sweden, aims to develop the human capital, while the ERDF goes to developing the underprivileged regions. As a sparsely populated part, the north gets more of the ERDF. Due to the climate and terrain, the Northern regions have trailed behind the other regions of Sweden in terms of development, and this has been reflected in the amount of regional development funds as well (European Commission 2016).[129]

Variances among the regions in terms of their development were crucial for the amount they received from the EU (Bache 2008). For the period of 2014 – 2020, Sweden will have gotten approximately 2.1 billion Euros from the Cohesion Policy. From this amount, 1.51 billion will be allocated to the more developed regions (of Sweden), whereas 207 million Euros will go to sparsely populated areas in the northern part of the country (Övre Norrland and Mellersta Norrland). 342.3 million Euros will be allocated for European Territorial Cooperation. Also 730 million Euros will go to the European Social Fund, and some remaining amounts will be used for local development and youth employment initiatives (European Commission, Cohesion Policy)[130]. Within the EU, countries like Italy and Spain receive higher amounts of regional funds overall, due to the higher number of poorer regions in these countries. Sweden is a net contributor to the EU structural funds and also has the lowest share of its population living in regions that are targeted by EU regional policy (Enflo and Rosés 2015).

The quest for getting involved in more EU related projects has also paved the way for a northern – southern division, mainly based on the existing differences. Northern and southern regions show variances in terms of their EU projects. For the ERDF, two-thirds of the whole fund was given to the three Northern NUTS- regions[131], – which make up 18 percent of the

[129] European Commission, Ex post evaluation of Cohesion Policy programmes 2007-2013, http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp1_sv_report_en.pdf

[130] European Commission, Cohesion Policy and Sweden, http://ec.europa.eu/regional_policy/sources/information/cohesion-policy-achievement-and-future-investment/factsheet/sweden_en.pdf

[131] NUTS-2 is a regional classification of the EU, based on the existing national administrative subdivisions. In this case, the NUTS-2 region Northern Narrland is made up of two counties: Västerbotten County and Norrbotten County.

population. From the whole ERDF budget, Övre (Northern) Norrland in the far north is getting 26 percent, while Norra Mellansverige is getting 21 percent and Mellersta (Middle) Norrland is getting 19 percent (European Commission 2016).

The remaining one third of the ERDF is distributed evenly among the other regions. As one of the *Västra Götaland* officials indicated in the interviews, the fact that the EU, to a large extent, has replaced the central government for the purposes of providing regional development might be conducive for the development of the specific regions, but in the long run, it may increase gaps in development among regions rather than fostering nationwide development[132]. In this vein, Lidström (2011) states that:

"*Central government has largely withdrawn from using intervention and redistribution in order to enhance regional development and even out regional differences. The responsibility is instead with the local and regional levels to make use of their assets and pursue their own development projects. This is often carried out jointly with private interests and is, in some parts of the country, co-funded by the EU. In the long run, this may lead to greater differences in wealth and well-being between different parts of the country.*"

Regional development prompts the concept of *jurisdictional competition*: The increased competition between regions and counties for resources from the national controlled instruments and programs, as well as from the EU funds, also represent a major challenge for the counties in Sweden (Engstrand and Åhlander 2008). In the words of an interviewed expert, "*The richer regions pay more much in the distributive system, and the regional differences are growing. Young people move away from big cities (because of the costs)".*[133] As another interviewee pointed out, "*The European Social Fund was* ***applied*** *nearly the same in every region, so that brings more standardization. It is also going towards securing more employment, and*

[132] Personal interview, Gothenburg, Sweden, March 2013.
[133] Personal interview, Gothenburg, Sweden, March 2013.

experimental projects”.[134] Again, this argument reveals the following side of the regionalization / decentralization argument: If in a decentralized structure all the regions get the same funds and are able to generate similar levels of opportunities for their inhabitants, then it would lead to more standardization.

It is especially important to look at how northern regions/counties use the ERDF funds in Sweden due to their geographical disadvantages. However, the use of regional funds does not always mean an emphasis on the disadvantages of the northern or peripheral regions, but also the championing of the “assets” of these regions and changing their priorities with time (European Commission 2008; Giordano 2016).

For example, in Northern Narrland (Övre Norrland), the official main priorities of the ERDF are strengthening research, technological development and innovation, increasing access to, use and quality of information and communication technologies (ICT), the increasing of the small and medium enterprises’ competitiveness, supporting the transition to a low-carbon economy in all sectors and promoting sustainable transport (European Commission 2016). The county of Norrbotten, found in Northern Norrland, is situated in the far north of the country, bordering Sweden and Finland, with a very harsh climate and low population density. National resources, wood processing and steel production are the main industries. Despite the fact that the region’s general economic performance is not weak, the fact that it relies on central government transfers and support for equal resources, e.g. in health and education, is a concern, especially with aging population (Giardano 2016). In 2000 – 2006, Northern Norrland was an “Objective 1” region, which is an objective “to promote the development and structural adjustment of regions

[134] Personal interview, Gothenburg, Sweden, March 2013.

whose development is lagging behind" (Eur Lex). In 2007 – 2013, Northern Norrland was upgraded into the "Regional Competitiveness and Employment Objective" (Analysis for Economic Decisions 2011) of the EU Regional Policy. Currently, the main objectives of the ERDF in Sweden's peripheral regions are making them more accessible, attractive and more open to innovation, showing effectiveness of EU's regional policy over the years (Analysis for Economic Decisions 2011).

The regionalization of Sweden also manifests itself in the way the regions implement the EU policies. As some *Vastra Götaland* officials stated in the interviews, the direct contact of the regional level with the EU in the implementation of these funds, bypassing the central government, illustrates the importance of regionalism, and the variances in the capacities of the regions in implementing these policies become ever more important. *Vastra Götaland* is a hub for trade and industry, and has the busiest port in the country. The regionalization of the country brings into light differences in terms of quality of government as well, e.g. with *Västra Götaland* being known as a well performing region with regard to its *quality of government* in Sweden as well as in the EU. As Charron and Lapuente (2011) suggest, this high quality of government in the region owes to "*the universal services that stem from national policies ensuring the impartiality of institutions down to the regional level, while still allowing regions independence in terms of regional development and economic decisions concerning to foreign direct investment and development"* (p.46). [135] Most of the revenues come from regional taxes, and the state grants contribute about 12.3 percent to the budget. Therefore, it is key that the region

[135] Other crucial reasons listed by Charron and Lapuente (2011) for the high quality of government for this region are listed as "whistle-blowing, meritocratic hiring practices, and media watchdog role", leading to less corruption.

spends on creating jobs and employment, so that the inhabitants earn enough money to pay taxes (Charron and Lapuente 2011).

As a *Västra Götaland* expert stated in an interview, in terms of dispensing the regional funds, the local governments are of key significance, which can highlight local differences in the nation:

"*New competences (about 65 percent) belong to the European Social Fund & Regional Development, and also education and sectoral type of programs. In terms of schooling, there are new responsibilities of local municipalities (as a result of these programs). Also in social affairs, the church is no longer an important institution like it was before. The church does not open schools and now you can open private schools and people prefer to go to those*"[136].

As the main cities in *Västra Götaland*, Malmö and Gothenburg – the latter a major industrial center - have very active EU projects. They have been given responsibility from the state to run regional projects. The Swedish Agency for Economic and Regional Growth, the Swedish ESF Council and the Swedish Board of Agriculture are responsible for implementing structural funds programs. An interviewer claimed that "*Special city districts should get this money (regional funds)*", as they will be useful for regional development. Therefore, there are questions about the appropriate level of government for the funds.

Västra Götaland has a growth strategy that responds both to the national strategy as well as the EU regional programs, as explained in the interviews. For the period, 2007 – 2013, *Västra Götaland*'s Regional Growth Program was related to EU's *Objective 2 Western Sweden* (regional competitiveness and jobs) as well as *Objective 3 Interregional Cooperation* between Sweden, Norway and Baltic countries. The prioritized areas in the region are business development, which includes entrepreneurship and boosting regional strengths, such as health, food, textile,

[136] Personal interview, Gothenburg, Sweden, March 2013.

automotive, communication, knowledge transfer and internationalization. Channeling the unitary and decentralized nature of governance, an official stated, "*There is a reciprocal influence between the regional growth programs and national strategy*".[137]

Summing up, with Sweden's entry to the EU, regional policy has emerged as another important force in the decentralization and regional process of Sweden, which requires an important balance between the unitary character of the country and regional disparities that might be reinforced within this process. Due to this possibility, it is a crucial topic to consider when examining the importance of territorial governance on inequality. However, research shows that so far, regional policy has facilitated convergence rather than divergence, and that the funds have been effective, especially for Northern Norrland (Analysis for Economic Decisions 2011).

It is challenging to establish a direct link with regional funds and income inequality. However, it is a point that should not be neglected in the study of territorial governance and inequality, especially for a country like Sweden where northern counties have benefited largely from the funds.

On another note, as in other European countries, the administration of European regional policy challenges the types of horizontal and vertical cooperation that already exists in the country. It is argued that the hierarchy between the central and local governments is affected, since local governments can bypass the central government in their communication with the EU, and that this can result in "nonhierarchical competition" (Feltenius 2016). As an important player in the relationship with the EU, the Swedish Association of Local Authorities and Regions

[137] Adapted and summarized from Region *Västra Götaland* documents, 2009.

(SALAR) has promoted merging of the county councils to fit the concept of “Europe of Regions” despite the fact that this did not happen (Feltenius 2007). Therefore, EU’s regional policies and the relationship with the EU in general have contributed to the regionalization discussion in Sweden to a considerable extent.

8.2.2 Quantitative indicators of decentralization: overlaps with rising inequality?

Examining the quantitative indices on Sweden’s decentralization between 1970 and 2016 in the Regional Authority Index (RAI) (Hooghe et al. 2016), we can see that the powers of the **county councils (*landstinge*)** have changed with time. There are three time periods for self-rule, 1950 – 1970, 1971 – 1999, 2000 – 2010, and two time periods for shared-rule, 1950 – 1970 and 1971 - 2010. **Table 17** displays the change of powers of the county councils over the years, looking at **self-rule** and the **shared-rule** components of this index. The **self-rule** aspect of regional authority is operationalized by the variables of *institutional depth, policy scope, fiscal control*, *borrowing autonomy* and *representation*. According to this index, the *institutional depth* level of the county councils in Sweden has not changed during the three time periods. The score is 2.0 in the range of 0 to 3.0, which indicates that the studied subnational units are comprised of a “non-de-concentrated, general-purpose administration subject to central government veto”.

The *policy scope* of the county councils has increased from a score of 1.0 to 2.0 (range of 0 to 4.0) as of 1971 onward, which means that the authoritative competences of the regional government changed from *at least one* of the following areas to *at least two* of the following areas: economic policy, cultural-educational policy, and welfare policy. County councils did not exercise economic policy in the period before 1971 but provided health care and they held ancillary responsibilities in industrial training and agriculture. The responsibilities of county councils increased after 1971 in regional development and public transport as well as health provision. Hence, the score in the RAI increases from 1.0 to 2.0, which indicates a decentralizing move. Also, it is important that the county councils have been directly elected since 1971 despite the fact there is also a centrally appointed governor (Hooghe *et al.*, 2016). Also, this time period witnessed the creation of *Skåne* and *Västra Götaland*, the two regions (*regionkommuner*).

The *fiscal autonomy* of the subnational units, being an important element in the argument of this dissertation, has stayed the same in the three periods. Nevertheless, it is important to point out Swedish county councils get a score of 3.0 in the range of 0 to 4.0, indicating high fiscal autonomy. The score of 3 indicates that "*the regional government sets the rate of at least one major tax: personal income, corporate, value added, or sales t*ax" (Hooghe *et al.*, 2010, p. 19). County councils determine the flat rate of the **local income tax** they levy, therefore Sweden gets a 3.0 score in fiscal autonomy, and approximately 75 percent of the revenues of the counties come from this source (Hooghe et al. 2010, p.115). Sweden's subnational fiscal autonomy scores are much higher than those in a federal country such as Germany, where the fiscal autonomy scores decreased from 4.0 to 2.0, looking at the period before 1966 and the period after (Hooghe et al. 2010).

Borrowing autonomy looks at the acquisition of money from domestic or international sources, which can constitute an important source of income along with intergovernmental grants or taxes (Hooghe et al. 2016). In addition to *fiscal autonomy*, this variable is important in understanding how subnational units can rule themselves. In the case of Sweden, the county councils are able to borrow without getting prior authorization by the central government.

However, their borrowing autonomy score has decreased from 3.0 (borrowing without authorization) to 2.0 (borrowing without authorization but with centrally imposed restrictions), because as of 2000, there is a centrally imposed rule of balanced budgets: County councils have to balance their budgets in three years.

The variable of *representation* is defined as “the capacity of regional actors to select regional office holders” (Hooghe et al. 2010). This score calculates both whether the region has an assembly and whether/how the executives are elected separately and then adds those scores. Assemblies get a score of 2 on a range of 0 to 2 for both time periods, meaning that the “region has a directly elected assembly”, and executives get a score of 1 on a range of 0 to 2 for both time periods, indicating that “the region has a dual executive appointed by the central government and the regional assembly” (Hooghe et al. 2016, p. 77). The assemblies of the county councils have been elected since 1912. In Sweden, in the period of 1950 – 1970, the local representatives of the county councils were indirectly elected and the government appointed the executive head. The county councils are directly elected as of 1971 and the executives are elected every four years concurrently with municipal and national elections. Also, as stated earlier, the county councils share their power with de-concentrated county administrative boards (*lansstyrelser)* with a centrally appointed governor (Hooghe et al. 2016, p. 397).

The **shared-rule** aspect of regional authority is operationalized by how much the subnational units share *law making, executive control, fiscal control, borrowing control and constitutional reform* with the central government. Concerning *law making*, Sweden gets a score of 1.5 for the period of 1950 and 1970, during which county councils were represented in the upper chamber of *Riksdag*, based on their population. This upper chamber ceased to exist as of 1971. Hence, the *law making* score for the subnational units decreases to 0 in the period of 1971

– 2010. Regarding *executive control*, which examines whether there are routine intergovernmental meetings between the subnational units and the central government, Sweden gets a score of 0 for both periods. It is important to note that this variable does not necessarily connote more decentralization, since it does not look at **horizontal interregional coordination** but looks rather at **vertical interregional coordination** (routine meetings or lack thereof). Hooghe *et al.* (2010) argue that extensive regional self-rule might decrease the necessity or the willingness of subnational units to engage in this type of relationship with the central government (p. 25). Therefore, if the level of autonomy, distribution of competences and task allocation are satisfactory for the local governments, it does not necessarily indicate an uncooperative relationship between the central and local governments, or less interactive governance. This will be explored further in the section on interactive governance.

Fiscal control is another important variable for the argument of this dissertation, as it is an important aspect of the **shared-rule**, which I argue is conducive for less income inequality. This variable looks at whether regional governments or their representatives in the legislature are consulted over the distribution of tax revenues, or whether they have negotiation or veto power. County councils had veto power over the distribution of tax revenues when they were represented in the upper chamber. Therefore, on a scale of 0 to 2.0, Swedish county councils get a score of 2.0 for the first period of 1950 - 1970. During the 1970s, the general practice was for the central government to make agreements with peak organizations of municipalities, which were non-binding. The *Riksdag* restricts regional and local spending has since 1982, therefore the score decreases to 0 for the latter period of 1971 - 2010 (Hooghe et al. 2016, p. 156). This is an important element that requires further attention.

The decrease of shared-rule in general, as operationalized in RAI, corresponds to the increasing income inequality levels in Sweden. However, the rise in inequality is especially visible in Sweden after the second of half 1990s and this operationalization looks at the period of 1971-2006 and allocates a score of 0 for the whole period. Therefore, this correlation warrants further attention, which can also be explained by other economic variables that explain rising inequality. Similar to the variable of *law making*, the *constitutional reform* power of Swedish *county councils* decreased from 4.0 (meaning that “regional governments or their representatives in a national legislature can veto constitutional change”) in 1950 - 1970 to 0.0 in 1971-2010 because of the transition from a bicameral to a unicameral rule. In the same vein, *borrowing control* looks at whether “the regions are routinely consulted over borrowing constraints and whether they have a veto”, and county councils have no *borrowing control* (Hooghe et al. 2016, p. 94).

In conclusion, in RAI, there is an increase in the self-rule but not in the **shared-rul**e of the county councils (*landstinge*) in Sweden. We see a decrease in the *fiscal control* of the regions, and this also correlates with an increase in the income inequality levels starting from the mid 1990s, which I will subsequently present in the next sections. *Fiscal control*, according to the theory of this work, operationalizes **shared rule**, and it is also correlated with more interactive governance according to the theory of this work. So, applying the theory of the dissertation, less fiscal control (less shared rule and less interactive governance) correlates with rising inequality. Yet, this correlation does not delve deeper into fact fiscal control is not the only operationalization of shared rule and interactive governance. Furthermore, the fact that income inequality has not skyrocketed to the levels of higher inequality OECD countries can be attributed to the central government’s welfare state policies with embedded equality principles;

observed throughout the country when the local governments implement them. I will elaborate on this point when analyzing the welfare state policies and inequality.

Table 17. Self-Rule and Shared-Rule Dimensions of the Regional Authority Index in Sweden

Self – Rule Dimensions

***Landstinge* (County Councils)**	**1950-1970**	**1971 - 1999**	**2000- 2010**
Institutional depth	2.0	2.0	2.0
Policy scope	1.0	2.0	2.0
Fiscal autonomy	3.0	3.0	3.0
Borrowing autonomy	3.0	3.0	2.0
Representation	1.0	1.0	1.0
Total self-rule	**10.0**	**11.0**	**10.0**

Shared – Rule Dimensions

***Landstinge* (County Councils)**	**1950 - 1970**	**1971- 2010**
Law making	1.5	0.0
Executive control	0.0	0.0
Fiscal control	2.0	0.0
Constitutional reform	3.0	0.0
Shared rule	**6.5**	**0.0**

Source: Regional Authority Index, Hooghe et al. 2010, 2016

Another index that warrants attention is Lane and Ersson’s (1999) classification of European countries with respect to specific constitutional autonomy criteria albeit with a cruder categorization. It looks at the following aspects of decentralization: *Federalism, special* *territorial autonomy, functional autonomy and local government discretion*. Sweden gets a score of 0 in all but one aspect: local government discretion, with a score of 3 on a scale of 0 to 3. Local government discretion, especially in fiscal matters, has altered after the date of that classification, as I will illustrate in the third section of this chapter, after explaining the evolution of the welfare state in Sweden. Nevertheless, this is another one categorization that reveals both the unitary character and the regional authority of local governments.

8.3 THE RECENT INEQUALITY TRENDS IN SWEDEN

8.3.1 National income inequality in Sweden

I argue that Sweden's inclusion in the low inequality countries can be attributed to, a) the centralized welfare state functions and political decisions that aim to achieve equality, b) the structure of the 'interactive governance' (especially in wage bargaining), which help offset the inequality inducing economic conditions. The following sections will provide more evidence for this argument. In order to link inequality and the independent variables, first, I present the changes in inequality levels in Sweden.

As a country with a "universalistic" Nordic welfare system, Sweden has a relatively more equal income distribution than many other countries in Europe and in the world, especially after taxes and transfers, as **Figure 25** shows below. Indeed, Sweden's income inequality levels are among the lowest in the OECD and in the world, despite increases mainly as of the second half of 2000s (OECD 2008; Brandolini and Smeeding 2009; Fritzell et al. 2014). This section aims to provide a general overview of Sweden's national income inequality levels, followed by regional income inequality, before looking at the relevant fiscal policies to further examine the link between decentralization and income inequality.

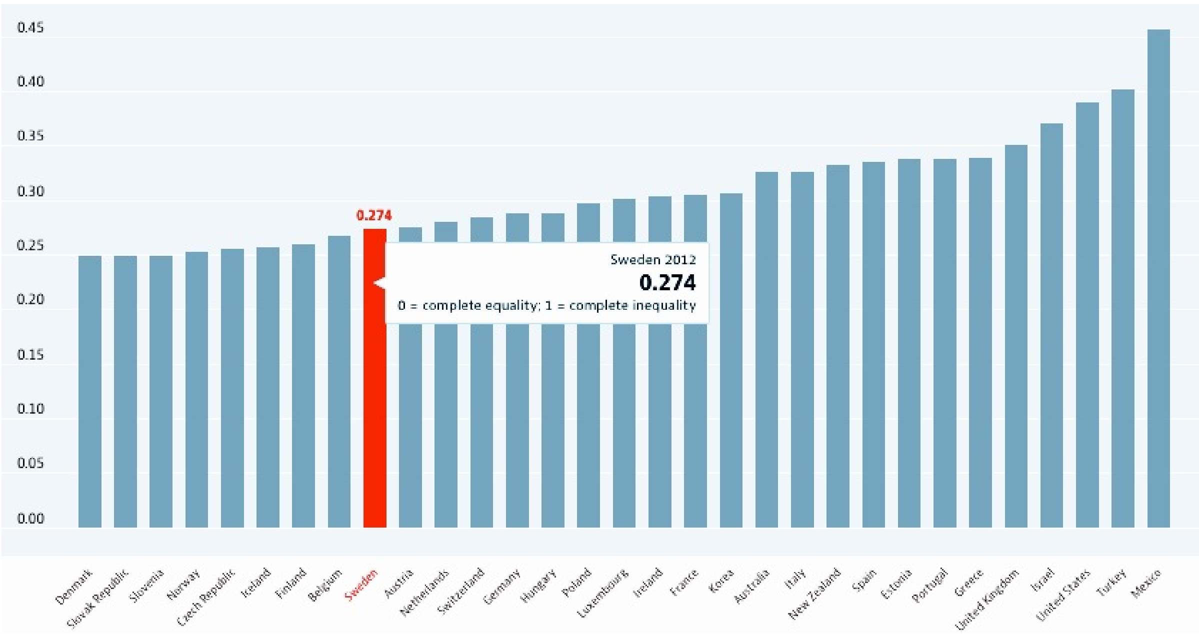

Figure 25. Income Inequality in the OECD Countries and in Sweden in 2012

Source: OECD (2016), Income inequality (indicator).
Gini coefficients of countries, household disposable income inequality
0: Complete equality, 1: Complete inequality

Despite the low levels of income inequality, the level of increase in income inequality in Sweden between 1985 and early 2010s was actually the highest among all the OECD countries, which is also in line with the general trends of inequality in the region. As **Figure 25** shows above, in 2012, Sweden had slightly higher income inequality than other countries in Western Europe, such as Denmark, Iceland, Finland and Belgium. Despite the recent upward trend in the 2000s (which seems to have halted), Sweden's income inequality has still not risen to the levels of many other high inequality OECD countries (Björklund and Jäntti 2013). According to the

Luxembourg Income Study database, dividing the income of 95th percentile of income earners divided by the lowest 5th percentile for data around the year 2004, Sweden is classified among the "low inequality" countries, along with Denmark, Finland and the Netherlands, with a ratio lower than 4.77.[138] In 2012, the top 10 percent of people with income earned 6.3 times higher than people at the bottom 10 percent. In the 1990s, this ratio was about 4 to 1, and in 2007 it was about 5.75 to 1 (OECD 2015)[139], showing the increase in earnings inequality with time.

Real annual average earnings inequality is on an upward trajectory when we look at the different percentiles of earnings. In Björklund and Jäntti's (2013) study, the real annual earnings among persons aged 20 – 64 from 1985 to 2009 in Sweden are examined. The increases in average earnings are calculated, as well as increases in for the 10th, 50th and 90th percentiles. The findings are that the distribution of earnings among the population is similar for all these percentiles except the bottom 10th percentile. The bottom 10th percentile was affected by the rising unemployment in the early 1990s, as well as between 2008 and 2009, due to the financial crisis. Studies show that despite increases in inequality, the disparity between the top and lowest income earners in Sweden is less than most other developed economies (Atkinson, Piketty and Saez 2010; Björklund and Jäntti 2013), which helps Sweden maintain its position as one of the "least unequal" countries.

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[138] Austria, Belgium, Germany, Hungary, Ireland, Luxembourg and Slovenia are classified as "middle inequality" countries with a P95/P5 between 4.77 and 6.61. Estonia, Greece, Italy, Poland, Spain and the UK are "high inequality" countries with a P95/P5 above 6.61 (Gyorgy Toth and Keller, 2013).

[139] The summary Swedish inequality data is taken from OECD Income inequality data update: Sweden (January 2015)

In the interviews, some factors that are related to the rising inequalities in Sweden as of the mid 2000s were expressed as the following:[140]

a) Weakening of the central administration system / more decentralization

b) De-corporatization

c) Decentralization bringing demand for strong central implementation (which is difficult to meet)

d) Administrative agencies are made up of half civil servants / half politicians

e) Composition of work force has changed – there is low human capital

f) Increase in unemployment (about 8 percent)– also as a result of the financial crisis–

g) Conservative government rule between 2006 and 2014

h) Unemployment insurance has lower coverage

i) Long term sick leave – early retirement

Björklund and Jäntti (2013) argue that looking at the income sources does not reveal any smoking guns for increasing inequality but taxes have become less distributive and less progressive and the incomes at the top are increasing, which might have likely contributed to this increase. A recent OECD report claims that the increase in inequality in Sweden should be attributed primarily to "widening gaps in market income sources" which are gross earnings, self-employment income and capital income that have become more unequally distributed (OECD 2015). In other words, the rapidly increasing earnings gap gave rise to the increase in inequality, measured in terms of the *Gini* coefficient. In Sweden, especially inequalities in original market incomes (before taxes and transfers) have increased sharply, similar to countries such as Canada,

[140] Personal interviews, Gothenburg, Sweden, March 2013. These are factors that are known to have contributed to changes in economic outcomes, however, it is difficult to attribute causality to them specifically as income inequality is a slowly changing variable.

Finland, Germany or the US. Yet, this increase does not translate to net income figures, showing high redistribution. In Sweden, the market generated income levels are similar to those of the UK or the US but Sweden reduced its market (gross) inequality by 45 percent whereas the UK decreased it 33 percent (Glennerster 2010, p. 698). While the redistributive effect of the Swedish welfare state has weakened as of the 1990s (Palme et al. 2002; OECD 2015; Fritzell et al. 2016), the effect is still stronger than the OECD average, and this will be explored in more detail in the section on the welfare state in Sweden looking at specific equalization figures.

Figure 26 shows both the market and the net income inequality figures (after taxes and transfers) and **Figure 27** shows Sweden's net income inequality levels. The rise in income inequality starting in the second half of the 2000s seems to have halted after 2010, especially in net income inequality.

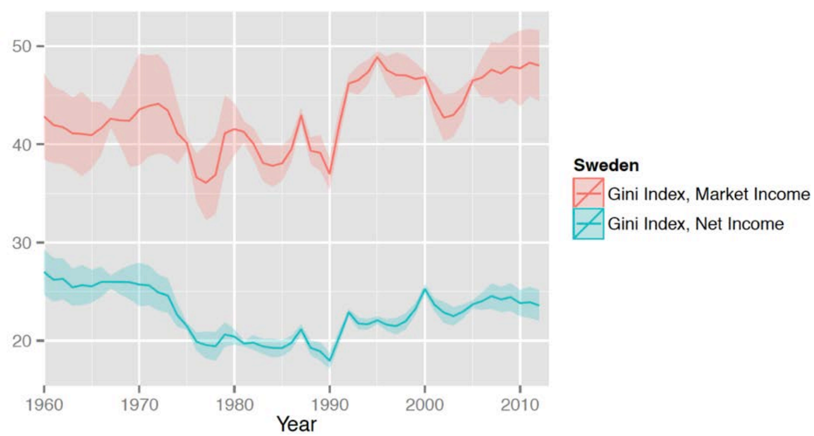

Figure 26. Market Income Inequality and Net Income Inequality in Sweden

Source: Standardized World Income Inequality Database (SWIID) v5.0, (Solt 2016).

Gini index on a scale of 0 to 100, 0 indicating perfect equality, 100 indicating complete inequality

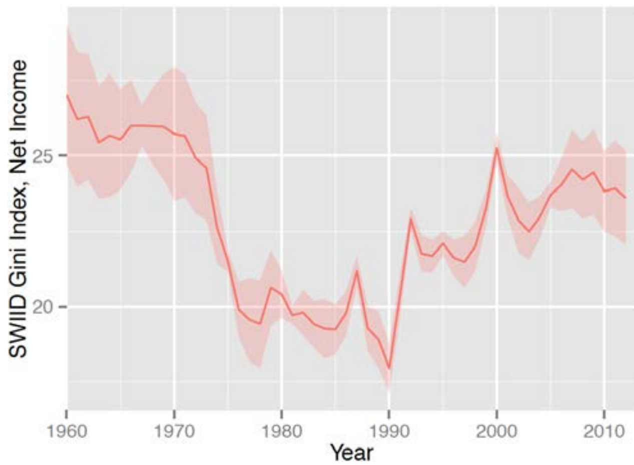

Figure 27. Net Income Inequality in Sweden

Source: Standardized World Income Inequality Database (SWIID) v5.0, (Solt 2016).

Gini index on a scale of 0 to 100, 0 indicating perfect equality, 100 indicating complete inequality

To understand the impact of taxes and transfers in Sweden, which will be explained in more detail in the next section, wage inequality figures are also telling. In Sweden, the gross income gap between labor market insiders versus labor market outsiders[141], before taxes and transfers is similar to the figures of other continental countries (about 32 percent). However, looking at figures from 2000, the welfare instruments make this gap smaller in Sweden (Häusermann and Schwander 2012, p.38-39). The net income ratio between insiders and outsiders in Sweden is 68.0 before taxes and transfers, and 75.1 percent after taxes and transfers, using data from Luxembourg Income Study for the year 2000. In France, Germany and Spain, taxes and transfers benefit the insiders, with the highest benefit in insiders accrued in Spain. Therefore, in addition to the taxes and transfers reducing the overall income inequality, Sweden's welfare state is more redistributive than these other three countries concerning the

[141] Outsiders are operationalized as the "individuals who belong to occupational groups (defined by class, gender and age) that are significantly more strongly affected by unemployment or atypical employment" (Häusermann and Schwander, 2012, p.47). The effect of welfare states (taxes and transfers) is measured both at the household and the individual level.

outsider / insider divide as well. Nevertheless, in the second part of the 2000s, the gap between the insiders and outsiders has grown considerably, and Fritzell et al. (2014) argue, this can be traced to some policy changes, more specifically the series of earned income tax credits introduced by the center-right government in power between 2006 and 2014, which altered the conditions of certain programs of social protection.

8.3.2 Regional income inequality in Sweden

In addition to national income inequality, regional income inequality figures bring into light the impact of territorial governance on inequality. As expressed in the interviews and as the section on EU regional funds also mentioned[142], the fact that the northern part of the country is less populated and much less developed mainly due to geographical obstacles is an important factor to bear in mind when looking at different types of inequalities in Sweden. A study by Enflo and Rosés (2015) on regional inequality examines Sweden according to its following geographical divisions rather than its current territorial governance structure: *Norrland* (the northern part), *Svealand* (the central part) and *Götaland* (southern part) as well as 24 counties (*län*) before the current reorganization of the territories. According to this study, regional inequality – measured by GDP per capita per region - has decreased in the period of 1860 - 1980, but did not follow the usual inverted U-shaped curve (which indicates first an increase due to industrialization and then a decrease). Overall, the level of regional inequality in GDP per capita shrank drastically from 1860 to 2000, with the *Gini* index for the regional inequality falling from 0.17 in 1860 to 0.09 in 2000. In the period of 1940-2000 and especially after 1980, the government policies played an

[142] Personal interview, Gothenburg, Sweden, March 2013.

important role for the evolution of regional income inequality. Regional convergence was intense from 1940 to 1980. In this period, Swedish governments aided the convergence in productivity among industries and the reallocation of the workforce from the declining to the thriving regions and economic sectors. Therefore, one can argue that *a centrally planned regionalized policy* helped regional convergence. In the 1950s, there were concerns about regional inequalities, but the main goal of regional planning was economic growth. During the next period (1980-2000), when regional incomes diverged, governments subsidized firms and people in the economically weakening areas. In the next section, I will look at the results of centrally steered economic equalization system to show how the state equalizes income and costs through various instruments, in order to apply the theory of the dissertation.

To examine recent regional inequality, data at the EU-NUTS-2[143] level are revealing. As **Figure 28** shows below, Stockholm and South Sweden are the most unequal regions in terms of net income inequality, followed by West Sweden and Upper Norrland. Only the Stockholm region surpasses 0.30 (out of 1), with a Gini of 0.314. Sweden's overall Gini level (SWE) is about 0.280. Overall, regional convergence in terms of inequality levels remains high.

[143] As classified by the European Union, Nomenclature for Territorial Statistics (NUTS-2): basic regions for the application of regional policies, second-level subdivisions, http://ec.europa.eu/eurostat/web/nuts/overview

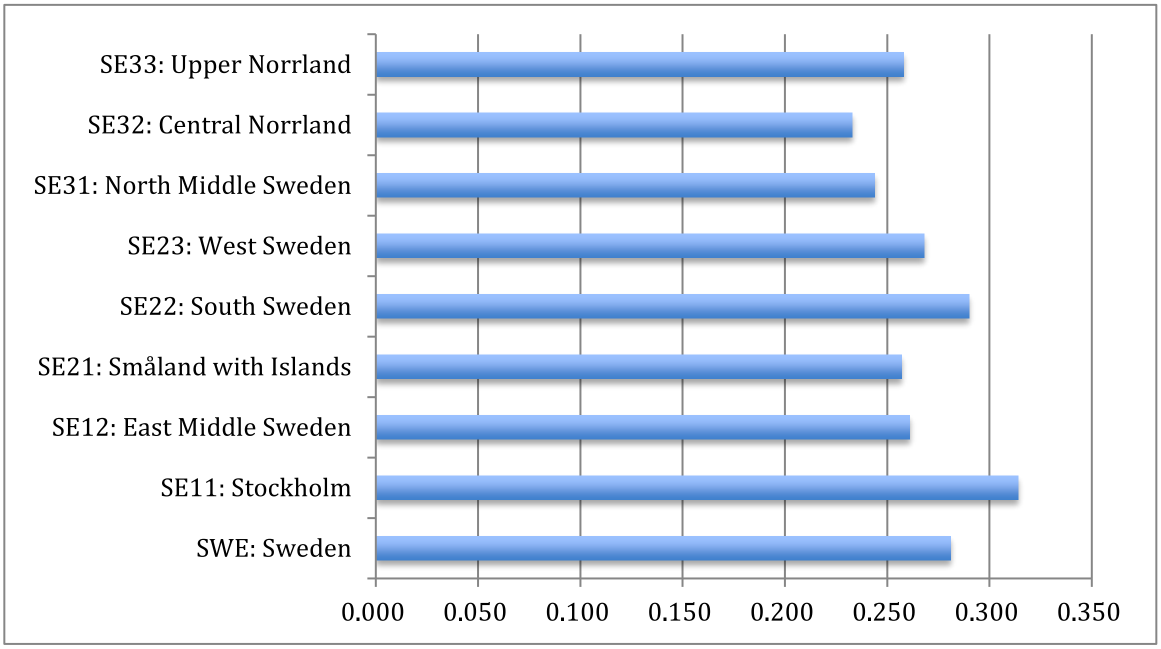

Figure 28. Sweden's Net Income Inequality Levels at Regional (NUTS-2) level

Source: OECD (2016)

Another measure of regional inequality is the GDP produced by each level overall in Europe's NUTS-2 regions in Sweden. As **Figure 29** displays below, the gross regional domestic product of Stockholm - measured in purchasing power standards per inhabitant, as percentage of the EU-27 average – is 179 percent of the EU-27 average, whereas the next highest region, Övre (Upper) Norrland, trails Stockholm with 121 percent. As this figure shows, none of the regions in Sweden fall below the EU-27 average, even those regions with less purchasing power per inhabitant.

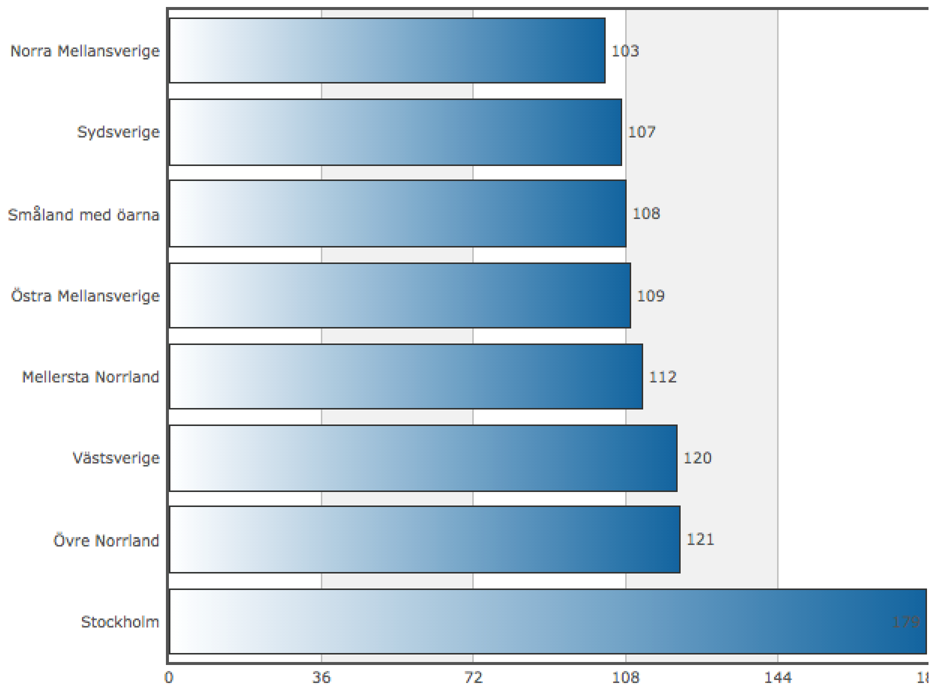

Figure 29. Regional Gross Domestic Product in Purchasing Power Standards in Sweden in 2010

Source: Eurostat, European Commission

8.4 WELFARE STATE IN SWEDEN AND FISCAL AND SOCIAL POLICIES THAT MATTER FOR INEQUALITY

Previous sections explained the sharing of competences in Sweden, and different types of decentralization in Sweden to create a foundation for testing the hypotheses of this dissertation. To test my hypotheses, I look at some of the **fiscal** and **social policies** of the welfare state that are impacted by the territorial governance structure in general and/or decentralization. I first outline the general characteristics of the Swedish welfare state in Sweden. Explaining the foundations of the welfare state is essential for understanding how the policies were first created and to what extent they have been maintained over the years. Then, I explain the tax policies, as well as the local government equalization system, governmental grants and their possible relationship with inequalities. This is followed by an overview of some social policies related to inequality in general, such as health care and unemployment and pensions policy.

8.4.1 The evolution of the welfare state in Sweden

"*Even though the Swedish welfare system offers relatively generous social security benefits (in terms of both eligibility and replacement rates) and spends more public resources on welfare than most other advanced industrial countries, it is not the expenditure levels which make it distinct, but rather the way in which it has institutionalized the values of* ***universalism*** *and* ***social egalitarianism***" (Blomqvist 2004, p. 140).

The concept of the Scandinavian or Nordic model of a welfare state can largely be attributed to the model of Sweden. Sweden exemplifies the Nordic social democratic welfare state regime type, which promotes an equality of standards instead of the clear-cut dualism between the *market* and the *state*, and which is considered as a distinct welfare regime type (Obinger et al. 2012; Esping-Andersen 1990; Esping-Andersen and Korpi 1987; Fritzell et al. 2014). As Steinmo (2013) argues, Sweden has never been a socialist economy but instead has always been a successful market-based economy where the Social Democrats worked "within the system" with a neo-corporatist structure (p. 86). When the Social Democrats came to power in the 1920s, they had interests in having organized interests prevail in policy making, in other words, corporatism, where both trade union representatives and enterprise representatives would be together for a harmonization of interests (Öberg 2016). The Nordic welfare state, and Sweden, has been shaped by its division of power between the church and the state as a result of Reformation and Lutheranism, and strong local as welfare state providers in cooperation with the central government (Kautto 2010). The centralized norm of achieving ‘equality’ reigns in the decentralized service delivery as well. A large range of public social policies, universalism, full employment aims and active labor market policies, as well as both flat-rate security and earnings-related benefits define the “Nordic welfare model” (Kautto et al. 1999; Nygard 2006).

An overview of the welfare state is important because inclusive and encompassing welfare states like Sweden are known to have more equal income distribution and lower inequality levels, which are applied throughout the country on an equal basis. Based on Korpi and Palme’s (2004) findings, Kautto (2010) states: “*Nordic strategy of redistribution is constituted by generosity and broad range of transfers, combined with a strong emphasis on free or strongly subsidized service provision. Taken together, these necessitate higher social expenditure but also lead to a lower degree of* ***income inequality***” (p.591).

The Swedish welfare state was created in the early years of the 20th century. As Blyth (2002) explains, the fact that Sweden industrialized late with a rapidly emerging working class enabled the emergence of strong trade union movement. A national pension plan was established in 1913, which was the first pension plan in the world with universalist characteristics (Sejersted and Adams 2011). At the end of the 1920s, the Prime Minister of Sweden, Per Albin Hansson, put forward the idea of ‘*folkhemmet*’ (people’s home). Pierson and Leimgruber (2010) argue that this was evident at least from the beginning of the social democratic power in 1932 until 1976, and *folkhemmet* meant that there is a “*national community which would provide a ‘good home’ for all its members, one grounded in equality and mutual respect*” (p.39). As Sejersted and Adams (2011) state, *“In Scandinavia the idea of* ***folket*** *(the people) as a community became “a characteristically democratic force”, in contrast to how this idea was used glorifying the dictatorship”* (p. 52). The nation – building of Scandinavia also rested on the creation of social policies, especially providing assistance for self-help and universality of welfare plans (Sejersted and Adams 2011).

The Nordic countries, including Sweden, come from the Beveridge-tradition welfare states with basic income security, which are also complemented by "*public or private solutions for earnings-related supplementary pensions*" (Ebbinghaus 2012, p. 183). Sector-level centralized bargaining emerged in the beginning of the 20th century beginning with the steel sector and spilling over to other sectors such as textile and reviving the unions, backed by the national leadership. The centralization of the unions continued in the 20th century in what is called a time of institutional "solidaristic regulation" (Swenson 2004, p.13). Negotiations between social partners became centralized and involved both the Swedish Employer's Confederation (*Svenska Arbetsgiveraforeningen* - SAF) and the Swedish Trade Union Confederation (*Landsorganisationen i Sverige* - LO), which gradually gained significance in the course of the 20th century (Blyth 2002).

Sweden and Norway are regarded as the only capitalist democracies that realized the "full-employment" commitment with active welfare and employment policies in 1930s with the strong political will of the Socialist Party. A "strong state" came to be synonymous with a universal welfare providing state. Also the fact that there was not a possibility of a unified bourgeois coalition also facilitated the rise of the welfare state (Esping-Andersen 1990). This type of social protection where earnings-related social insurance benefits complemented the basic benefits and services became a distinct feature for the encompassing Nordic welfare states (Palme 1999; Kautto 2010).

The Social Democratic Party (SAP) governed Sweden without any interruptions from 1932 to 1976, which also consolidated the political will to establish the welfare state (Blomqvist

2004). This welfare system was used by the Social Democrats to convert the agrarian country to a more developed society that would ensure egalitarianism. While the welfare states in Scandinavia diverged around the middle of the 20th century, the social democratic model is demonstrated as a "model of balanced full-employment welfare-state growth", and therefore, maximizing revenue became an important issue as well. In the aftermath of World War II, Sweden witnessed political debates on pensions reforms with the new economic growth (Hay and Wincott 2012). Esping-Andersen (1990) expresses some factors that contributed to the importance of meeting the costs of the system as follows:

"*Strong universalist trade unions, and a labor party capable of dominating the political coalition of farmers and workers that, in the first place, permitted social democratic ascendance… On the one side, the right to work has equal status to the right of income protection. On the other side, the enormous costs of maintaining a solidaristic, universalistic, and de-commodifying welfare system means that it must minimize social problems and maximize revenue income*" (1990, p. 167).

Starting in 1951, the economic policy of the economists Gösta Rehn and Rudolf Meidner played an important role in shaping the welfare state and its outcomes. The wages of the lowest paid workers were increased and the system of "equal pay for equal jobs" was promoted in order to increase the redistributive impact of the welfare state. This also contributed to economic productivity since those that paid low waged were phased out. Also, there were active labor market policies such as training, retraining and relocation grants. Thus, regional growth policies of the time were pursued at a national level despite the fact that some regions grew more than the others (Enflo and Rosés 2015). The state pursued policies that would keep the profit levels down through taxation to transfer private profits into public savings, which would then be beneficial for further distribution; all of which contributed to the institutionalized and "embedded liberalism" within a strong welfare state (Blyth 2002).

The Social Democrats in Sweden needed to establish nationwide political institutions and institutional relationships that would guide the country (Blyth 2002). Throughout the 1940s and 1950s, and continuing into the subsequent decades, the corporatist structure in the Swedish welfare state was consolidated. As Sejersted and Adams (2011) state: "*Social Democratic regimes in Sweden and Norway were noted for strong trade union organizations and far-reaching corporatist systems that had, on the whole, worked well*" (p.361). The first universalistic social insurance reform was passed in 1946 by the Social Democratic government, bringing an increase to the flat-rate pension, which was actually championed by the Conservative Party and was against means-tested solutions. Comprehensive health insurance with generous health benefits and sick pay was also passed in a similar way in 1953. Also there was an alignment between the employers' interests and the labor market policy, which paved the way for the "Active Labor Market Policy" (Swenson 2004).

In 1976, Socialist Party lost power for the first time in decades, but there was not much reversal of the Swedish welfare state, at least until the 1990s (Hay and Wincott 2012). In the early 1980s, the most important actors began to negotiate separately, starting a process of de-corporatization and a more "*diverse picture of interest representation, both for employers' organizations and trade unions"* emerged (Obinger et al. 2012, p. 191).

During the 1990s, the priorities and the outcomes of the Swedish welfare state changed to a large extent with the so-called "retrenchment" of the welfare state, which, is argued to have paved the way for higher inequality.[144] Dahlström (2009) argues that the key bureaucrats of the government offices or agencies played a key role in the welfare retrenchment oriented policies.

[144] Welfare state retrenchment can have different connotations in different contexts, but in this work, I refer to it as "*any changes in state provided social rights that make them less attractive or generous*", based on the definition of Dahlström (2009) and Korpi (1983).

Over the past 20 years, significant changes have taken place to ask whether the Swedish welfare state model still exists. The scope of social protection has somewhat been reduced even if the Swedish welfare state is still generous and encompassing in comparative perspective. The two key elements of the Swedish welfare model, which was full employment and stable growth could not continue in the early 1990s, due to the recession, and public spending had to be reduced as well (Huber and Stephens 1998; Anderson 2001). Reforms of the social security system and employment protection legislation have had *dualizing* effects, meaning that insiders and outsiders of the market do get different levels of benefits and face different eligibility rules. Proliferation of part-time and fixed-term employment was also behind less secure benefits, and also pronounced as a factor to increase inequality (Obinger et al. 2012, p. 194).

Again, while the insider-outsider divide is less pronounced in Sweden, the reforms concerning sick leave, pensions and family policies pension had crucial distributional consequences, which led to the furthering of the insider-outsider divide (Obinger et al. 2012)[145], also closely associated with rising inequality. Trade union membership currently stands at about 71 percent, which has decreased from its highest percentage in 1995 with 86 percent.[146] This still remains as a high percentage, but the decrease in union membership is also related to the divide between insiders and outsiders. I will return to trade union membership in the last section of the chapter when I explore social actors and interactive governance in Sweden.

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[145] Iversen and Stephens (2008) find that insider-outsider conflicts are mainly the outcome of Christian Democratic rather than Social Democratic governments.

[146] Worker-Participation.eu http://www.worker-participation.eu/National-Industrial-Relations/Countries/Sweden/Trade-Unions and Eurofund, http://www.eurofound.europa.eu/observatories/eurwork/articles/industrial-relations/sweden-fall-in-union-density

During the 1990s, social spending was on the rise but unemployment also rose. Hay and Scott (2012) argue that the welfare state generosity was maintained but they fell as of the late 1990s, continuing into the 2000s, which also overlaps with times of increasing inequality. The early 1990s also witnessed a severe economic crisis, and massive unemployment ensued. In the first retrenchment package, sickness and work-accident insurance, the retirement system, housing policy and family policy were affected, with some tax increases for the medium and high-income groups. The second crisis package aimed at lowering the costs for the companies with lower payroll taxes. Some other changes were changes in replacement rates in parental insurance and in unemployment insurance (Scruggs 2006; Dahlström 2009).

The 1990s was also a time of privatization in Sweden, which was significant for the education, healthcare and other welfare state services (Andersson 2016). Blomqvist (2004) argues that this gave rise to a "*socially segregating dynamic, prompted by the introduction of "consumer choice*" (p. 139). Officially commissioned by the state, *Welfare Commission's* (Palme et al. 2002) analysis of the welfare state revealed decreasing median disposable household incomes in the 1990s. The lower parts of the income distribution did not have a substantial decrease in their incomes compared to the median income, but the people in the upper part of the income distribution saw their incomes increase more in relation to the median income, being 162.4 times of the median income in the early 1990s, and rising to 174.4 times at the end of the decade, as shown below in **Table 18** (Palme et al. 2002).

Table 18. Income Ratios of Low and High Income Groups in Relation to Median Income in Sweden

Sweden	INCOME INEQUALITY	
	Beginning of 1990s	End of 1990s
Low incomes (P10/P50) (in relation to median income)	65.0	64.4
High incomes (P90/P50) (in relation to median income)	162.4	174.4

Source: Palme et al. (2002)

When the Social Democrats returned to power in 1994, they pursued reforms that were against the predicted ideological principles, which were "*framed, politically, as active reforms of the Swedish model, moving toward market values*" (Andersson 2016, p. 572). It is argued that some cuts that were done by the Social Democratic government in power between 1994 to 2006 were more visible in areas that mattered for the welfare state than those that were implemented by the center-right coalition government that followed (Rothstein 2016).

Based on this information about the origins and the general principles of the welfare state in Sweden, I now turn to explaining the fiscal and social policies that matter for inequality.

8.4.2 Fiscal and social policies and the territorial governance structure: taxes and equalization in Sweden

"*Sweden's tax-extractive capacity is unique and related to the solidarity supporting the welfare state*" (Esping-Andersen 1990, p. 184).

“The paradox in Sweden is that while the constitution guarantees the political and financial autonomy of the municipalities, it also stipulates that welfare provision is based in equity and equal access, which implies a high degree of centralization” (Gallagher et al. 2011, p. 187).

As the two quotes above suggest, the Swedish system of social services is highly decentralized (more so than many federal regimes), but the central social programs are set at the center, thus producing more capacity for redistribution. Sweden is included in the Nordic family of taxation, with more emphasis on income taxes and more moderate business taxes and lower social security contributions. Sweden is also well known for its revenue decentralization. According to a 2008 report by the Swedish Association of Local Authorities and Regions (SALAR) and the Swedish Ministry of Finance, local income tax finances 70 percent of the municipal and county council costs and about 17 percent came from central government grants.[147] The local government makes up almost 20 percent of the gross national product in Sweden.

Subnational governments finance most of the regional public expenditure and services. Yet, they have to satisfy the minimum level of quality that the central government requires. Furthermore, local governments cannot legally default on their debt, which limits their autonomy (Vigneault 2007, p. 152), and as stated earlier, they have to keep their budgets balanced. The tax base rules and the design of the equalization scheme come from the central state. As the previous section indicated, there is not a high level of *shared-rule* especially in terms of determining the local tax rates as the local tax rates are expected to be around 30

[147] Local government financial equalization: Information about the equalization system for Swedish municipalities and county councils in 2008, SALAR

percent. Thus, it can be argued that the tax system is a *centrally designed* and *steered* one *with decentralized implementation* by the local authorities.

County councils determine the flat rate of the local income tax they levy. Therefore, in the Regional Authority Index, Sweden's county councils gets a 3.0 score out of 4 in fiscal autonomy (that they can set the rate of at least one major tax), and approximately 75 percent of the revenues of the counties come from this source (Hooghe et al. 2010, p.115). According to 2013 figures, the local tax rates ranged from 28.89 per cent in Vellinge municipality to 34.32 per cent in Hofors municipality (Swedish Statistics Bureau and Swedish Tax Agency 2013).[148]

Currently, throughout Sweden, for people who make less than 413,200 Swedish Krona (SEK), no income taxes are imposed. For people who make between 413,201 and 591,600 SEK, the income tax rate is 20 percent and for those who are making more than 591,600 SEK, the rate is 25 percent, indicating a progressive system. Also, taxes on income from capital are 30 percent and corporate income tax is 22 percent. Since 2005, there is no inheritance tax.[149] There has been an important decrease of income and property taxation in general, as well as the abolishing of wealth and inheritance taxes. In the case of Sweden, it is difficult to tease out the specific impacts of taxes on income inequality. However, as Fritzell et al. (2014) argue, the previously mentioned earned income tax credits for those in unemployment, and the decreases in the replacement rates in unemployment compensation and sick pay can be regarded culprits of this increase.

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[148] In the interviews, the increasing importance of local taxes was raised, the levels of which can vary in different municipalities – also according to whether municipalities are more left-wing or not.
[149] Figures from the Swedish Statistics Bureau and the Swedish Tax Agency, https://sweden.se/society/why-swedes-are-okay-with-paying-taxes/

The fact that local authorities may determine and raise local land value tax is a decentralized feature of the tax system (Gallagher et al. 2011). The local taxes are collected by the Swedish Tax Agency and this agency adjusts the tax revenue for grants or charges. Despite the importance of local taxes, the key role of the central government in taxation in Sweden is evident with the possibility of local tax freezes. Sweden experienced some local tax freezes in the past, as it was expected for the local taxes not to exceed 30 percent (Larsson and Båck 2008). This became a contentious issue especially in the 1990s. When the government restricted the increasing of local taxes, once in 1991- 93 and then in 1997 – 99, it led to a local level tax freeze, resulting in frustration among local level politicians. They argued that this was actually against the rights granted in the Constitution to decide on their own taxes at the local level (Feltenius 2007; Loughlin et al. 2005). The lack of shared rule in local financing, as also evidenced by RAI, leads to some contentions as explained by Larsson and Båck (2008): "*The construction of the equalization scheme is a constant source of conflict and antagonism both between central and local level and between different groups of government*" (p. 214). Nevertheless, the financial equalization system is applied with a more standardized structure in Sweden than in other Western European countries, such as Spain. The overall degree of financial equalization in Sweden has been strong (Chernick 2004).

The following quote summarizes why a combination of a decentralized tax system with a centrally steered fiscal equalization system carries so much importance for Sweden to bridge various gaps in different localities:

"… Local authorities differ in their ability to meet their tasks because there are major differences in taxable income per inhabitant (tax capacity) between municipalities and between county councils. This is primarily true of municipalities and is due ***not only to differences in***

inhabitants' earned income *but also to differences in differences in employment levels and in the age structure of their population*" (Ministry of Finance & SALAR 2008).

As this excerpt from the official report indicates, earned income, as well as employment and age differences lead to variances in subnational units' tax capacities, and the equalization system aims to bridge the gaps in tax capacities throughout the whole population, and not just in certain subnational units.

Based on these ideas, the local financial equalization system - the current version in operation since 2005 - , is composed of: *a) income equalization b) cost equalization, c) structural grant, d) transitional grant, e) an adjustment grant charge (central state grants).* As specified by the Swedish Agency for Public Management (*Statskontoret*), the purpose of the Swedish municipal equalization is "*to create the financial conditions necessary for local government to be able to offer a similar level of service to their residents in all parts of the country, regardless of varying income levels and other structural factors*". The equalization system is technically not a grant from the central government, but rather a set of fiscal flows between municipalities, yet certain grants also exist, indicating both the horizontal and the vertical nature of the systems. Positive flows just offset negative flows, so the system is self-financing.

Before the current financial equalization system came into effect in 2005, there were also combined general grants and transfers by the central government. There was a central grant transfer system so that all local governments are brought to a "national average fiscal capacity" (Shah 2007). Special grants were given looking at the population size, composition and location and municipalities that make more than 135 percent of the average are the contributing ones. In 1993, a major reform of the Swedish equalization system took place. Substantial further modifications were made in 1996. A number of categorical grants were replaced by a single block grant, and an equalization system was introduced in 2005.

Income Equalization System: The central government finances the bulk of the income equalization between local authorities. There was a general government grant for municipalities and county councils before 2005 instead of the horizontal income equalization grant – which is still mainly financed by the government.[150] Income equalization is based on the difference between the taxable income of local authorities and a tax equalization base that corresponds to 115 percent of the national average tax capacity for municipalities and 110 percent for county councils. If the taxable income of the municipalities and county councils is above these levels, they need to pay the income equalization charge to the government.

Cost Equalization: The cost equalization system is another instrument of the centralized financial system for redistributing economic resources among municipalities and among county councils and to correct gaps in structural costs (Swedish Agency for Public Management 2014), again indicating the centralized nature of the system. Cost equalization is used for costs that the local authority cannot itself influence and a system to redistribute economic resources among municipalities and among county councils. The main reason for this cost equalization grant is that the level and the need for services vary among counties and municipalities. Since 2008, the cost equalization considers the "*structural differences in wages that affect the cost of operating in different parts of the country*". Differences resulting from the chosen service, efficiency, service quality and levels of user fees are not equalized in the cost equalization system.

[150] After this date when the grant system changes (circa 2005), income inequalities have been on the rise in Sweden. While it is difficult to attribute direct causality to the changing of this system, it is important to investigate the magnitude of this effect.

The cost equalization system that is applied to the municipalities is comprised of ten different sub-types - such as *university education, public transportation, health and medical care* -, an important one being the individual and family care (IFC) model. Municipalities are paid higher based on the deviation of the municipality's age structure from the national average age structure (SALAR & Ministry of Finance 2008). Changes are proposed for the IFC model to improve the cost equalization outcomes in municipalities where a high number of unemployed people do not receive benefits and where many people in poverty live. The main variables for changes in this IFC model focus on unemployed people, people between ages of 20 and 40 with low levels of education, the size of population and child poverty (The Swedish Agency for Public Management 2014).[151]

Structural grants are another component of financial equalization system, which are paid to 94 municipalities and 6 county councils, mostly paid to the "sparsely populated counties in the North and East central Sweden", as well as Malmö where inequality levels are high (Ministry of Finance & SALAR). The rationale behind the structural grants is similar to the EU's structural funds. The three northernmost county councils and three county councils in Southern Sweden, including Gotland Municipality, also receive a structural grant. The equalization system has vertical and the horizontal aspects, and municipalities and the county councils can either get a grant or pay a charge to the central government.

[151] With the current model, the funds redistributed between municipalities in 2014 amount to a total of SEK 4.2 billion. The proposed changes, calculated in the same year, would increase the annual redistribution to SEK 4.5 billion, i.e., they would lead to somewhat higher redistribution among the municipalities.

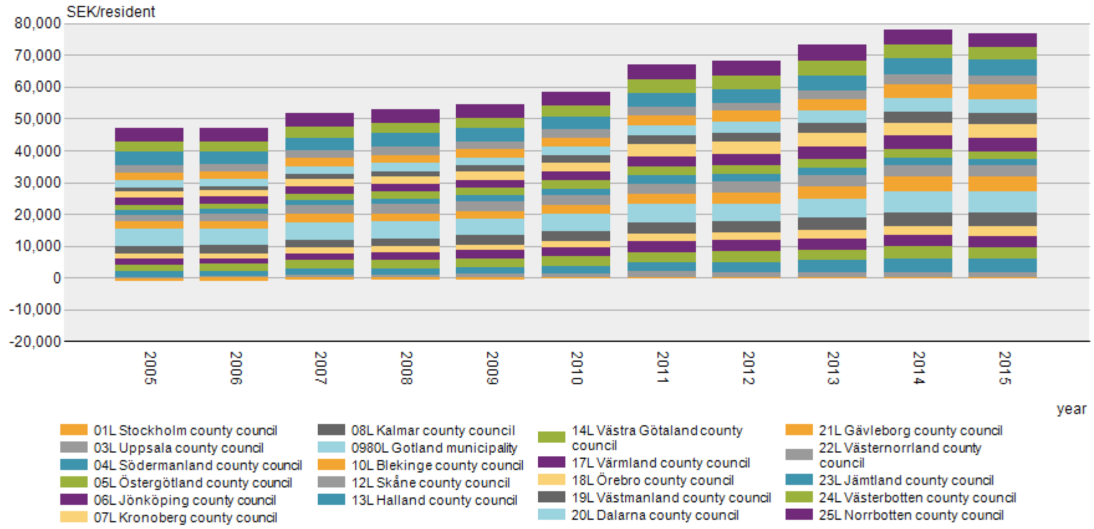

Figure 30. Economic Equalization in Sweden, SEK/resident, 2005-2015

Source: Statistics Sweden (2016)

Figure 30 above shows the aggregated results of all the different components of the economic equalization, and how much each county council either received from or paid the central government. Stockholm County council is the only one that pays in this system, showing a negative value below zero, but the amount that it pays decreases over time. Gotland County council is the biggest receiver of economic equalization. The amount distributed for income equalization has risen over time, showing only a slight decrease from 2014 to 2015.

8.4.3 Example of social policies: health policy in Sweden

In Sweden, in line with its welfare state categorization, there is a Beveridge-type of public health care provision, through its 21 counties and 290 municipalities – which are both tax-levying levels (Fredriksson, Blomqvist and Winblad 2014). Analyzing the healthcare system is important since local government provision and implementation of centrally created policies is informative about the decentralized unitary state of Sweden. The healthcare system is mainly publicly financed, and the revenues are raised by central and local taxation by county councils and municipalities, so there is shared and decentralized rule. Central government grants are available for healthcare, distributed again to county councils and municipalities. The geographical differences in Sweden are important since the government also allocates grants to geographically underprivileged locations (Anell 2008). County councils provide mental healthcare, primary and specialist care in hospitals, whereas municipalities focus more on home care.

There are six medical care regions, constituting a different grouping of the county councils for health care provision: Stockholm Region, the South-Eastern Region, the Southern Region, the Western Region, the Uppsala–Örebro Region and the Northern Region (Anell, Glenngård and Merkur 2012). According to Øvretveit, Hanson and Brommels (2010), 23 percent of healthcare comes from state grants and national insurance, 59 percent from county taxes, 11 percent from charges to patients, and 7 percent comes from what communes pay to county councils for the competences that they have assumed.

Decentralization in health care, also bolstered by the implementation of New Public Management reforms in the 1970s and 1980s, was followed by a need to boost national influence to eradicate differences and to ensure better coordination after the mid 1990s (Anell et al. 2012). In 1992, local municipalities took over the competence of long-term health care for older people, and in 1996 the responsibility for the physically disabled and mentally ill as well as home care services.

The rate of decentralization has also varied among different county councils. The health care policies regarded as one of the “third generation policy fields” (Pierre, Jacobsson and

Sundstörm 2015), and Sweden's decentralized decision making and intense relations between the private and the public sector make Sweden an appropriate case to evaluate its governance structure through an examination of such social policies (including its health care).

As Anell et al. (2012) explains:

"*The degree of decentralization, organization and management has come to vary considerably among county councils. As a result, the tradition of local self-government has led to regional differences in the governance and provision of health care between county councils. Local self-government is partly intended to create different solutions to service delivery rather than similar services in all county councils and regions… During the latter part of the 1990s and the 2000s there have been efforts toward strengthening national influence, partly driven by the need to better coordinate care* ***and to reduce regional differences***" (p.29).

Fredriksson et al. (2014) argue that the creation of the Swedish National Guidelines in health as well as the relocation of the decision-making capacity towards the central government indicate trends of recentralization in healthcare in Sweden and lessening of local autonomy, moving towards more standardization with the aim of reducing regional differences.

Reforms in the 1990s and the 2000s created more room for choice for the patients, and therefore also fore competition in especially primary care, which is also closely linked to decentralization. One of those is the Health and Medical Services Act, which gives the counties autonomy to organize their services to treat the patients with the best possible conditions. Also, mergers between county councils brought a "regionalization" of the health care services (Anell et al. 2012). It is argued that in terms of choice of care and local health care provision, there is competition among the municipalities, rather than integration, which could lead to outcomes with disparities in the future (Ahgren 2010). For example, in 2007, the County Council of Halland created a "choice of care" framework, which means that citizens can choose their doctor or primary center care as purchasers. With this system, citizens are regarded as purchasers who can choose care providers (Øvretveit et al. 2010); and the choices of the citizens would generate income to the units, which then creates competition. Halland's practice also prompted 15 other county councils to follow suit, but among the different county councils, there are important differences regarding the requirements of the providers and the subsidies they receive (Ahgren 2010). In order to prevent differentiation, "local health care" practices with more community-oriented principles have been developed with an eye to more integration. This is also reflected in Ovretveit et al.'s description of the health system (2010) as the "development of an integrated health and social care organization in Sweden combining service provision, purchasing and political governance for a defined population" (p. 113).

Figure 31 below shows the number of active physicians per 1000 people in different regions of Sweden, as well as Sweden's average, based on OECD data between 2001 and 2012. The number of doctors has increased for all the regions, and for Sweden on the whole; however, the gap between North-Middle Sweden and South and East Middle Sweden is substantial.

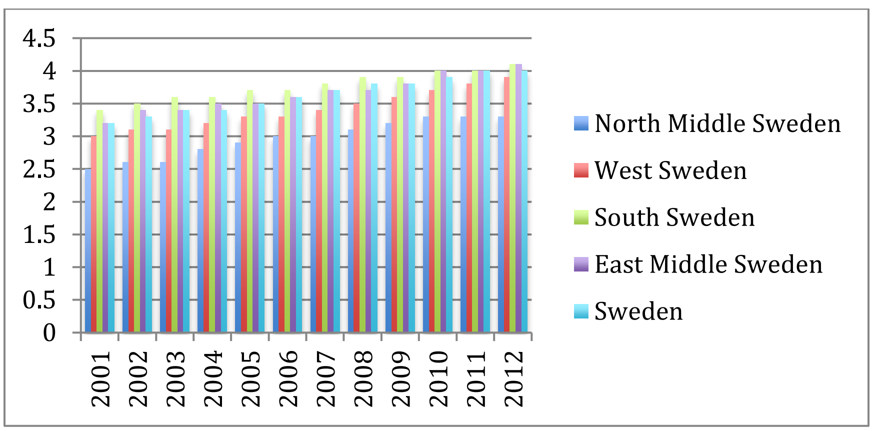

Figure 31. Number of Active Physicians in Sweden per 1000 people, 2001 and 2012

Source: OECD (2016)

8.4.4 Example of social policies: unemployment and pensions policies in Sweden

The Nordic welfare state model is manifested in the social insurance programs, which were earnings-related when they were first founded. Looking at the unemployment benefits as net income replacement ratios, the Nordic welfare states provided the most amounts to sustain the high generosity levels (Hay and Wincott 2012). Also active labor market policies were first decentralized and then centralized again in Sweden (Hemerijck 2013; Clasen and Clegg 2011, p. 34).

Employment rate is closely associated with income inequality, directly and indirectly through its impact on earnings inequality in Sweden (Saunder, 2010). Therefore, as stated earlier (Frizzell et al. 2014), changes to the unemployment policies, such as decreases in rates of replacement, are linked with rising inequality figures, despite difficulties in singling out the impact of this one variable.

In the 1990s, due to high unemployment, the unemployment insurance had to be restructured and the relations between the trade unions and political parties were of antagonistic nature in the decision making process (Obinger et al. 2012, Bergh and Erlingsson 2009).

Currently, there are two types of unemployment insurance systems in Sweden. The unemployment insurance programs started in Scandinavia and Continental Europe in the form of voluntary state subsidized insurance, where state was regulating and subsidizing the funds and the unemployed can get benefits by being a member of the funds. This system, also known as the “Ghent system” is still in place to a large extent in Scandinavia, including Sweden (Sjöberg et al. 2010). With the inclusion of labor unions in the system, the coverage of this insurance grew over time in Sweden, therefore the centralized expansion of the unions also made an important contribution. This earnings-related benefit for the insiders, which is financed by the membership fees and employer contributions constitute one part of the unemployment insurance. The other one is basic insurance, (*grundförsäkring*) financed by employers' contributions, which cover those not voluntarily insured and provide a flat-rate benefit. Those that lose their job are entitled, under certain conditions, to the basic or the earnings-related unemployment benefit. There is not much coordination between the two types of unemployment insurance systems: "*Furthermore, the strong growth in collectively bargained unemployment insurance arrangements is recasting a differentiated benefit structure, outside the strictly public schemes*" (Clasen and Clegg 2012, p. 146). Therefore, the centralized nature of the system brings relative standardization, but if the differentiated benefit structure, or in other words, dualism, becomes the norm, this can be associated with rising income inequality (Fritzell et al. 2014), yet we need to make this statement with caution.

Pensions policy is another important welfare state policy for the discussion of inequality. Sweden is one of the pioneers of an earnings related pension system, which was created again through a very politically charged process, where the trade unions and the left parties were against the business organizations and the non-socialist parties (Kangas, Lundberg and Ploug 2010). In the 1990s, in Sweden, the pension reforms created the following: "Notional defined contributions" (NDC) which make public benefits dependent on individual working life contributions and the macroeconomic-demographic development (Ebbinghaus 2012). Political parties had to secure the support of the other parties, and the new system created an abolition of the previous system as a whole. Kangas et al. (2010) describe the process as follows: "In Sweden, the reform was a path-breaking, punctuated turning point where the old program was eliminated and replaced."

The aim was to make the public pension programs more like a private retirement saving system by linking individual pension entitlements very closely and explicitly to actual contributions paid (Adema and Whiteford 2010, p. 135). Swedish Pensions Agency took over in 2010 for all national pensions, indicating a more centralizing move concerning an important welfare state policy. I will discuss the pensions policy again in the section on the roles of social actors in policy making.

8.4.5 How redistributive is the Swedish welfare state?

In Sweden, income taxes and cash benefits have normally played a key role in income redistribution, and reduction of inequality is slightly higher than the OECD average, with 28 percent reduction of income inequality in Sweden, and 25 percent as an OECD average. However, before the mid 2000s, which is before the recent inequality increase in Sweden, this rate was about 35 – 40 percent (OECD 2015).

Looking at cost equalization data, one can see that the amount of money distributed specifically with this instrument decreased in the period of 1996 – 2013, both in municipalities and county councils, which is associated with the time of welfare state retrenchment. The system redistributed 7.8 billion SEK in 1996 for municipalities, whereas this amount was 6.6 billion SEK in 2013. For county councils, the decrease was more drastic: 5.9 billion SEK was redistributed in 1996, and in 2013 the amount was 1.5 billion SEK. However, the difference between the amount of the highest grant and the highest charge also decreased during this period, showing more regional convergence, despite increasing overall income inequality (The Swedish Agency for Public Management 2014). Also, more municipalities were contributors to the system. In 1996, 183 out of 288 municipalities were fee paying. Currently, the number of municipalities that pay and receive are almost equal, which is another indicator of regional convergence in Sweden.

However, if we look at a longer time period, the redistributive impact of the welfare state on the poorer part of the population is more pronounced in Sweden than in other OECD countries. Mahler et al.'s (2013) study looks at the effect of taxes and transfers on five income quintiles in 14 OECD countries, by ranking households by their pre-tax and pre-transfer incomes for the years 1979 – 2006. Then by adding taxes and deducting transfers, the authors conduct another ranking of redistribution. The results of this calculation are shown below.[152] Among the 14 countries that are in this study, Sweden increases the share of the poorer quintiles to a large extent, indicating high redistribution: For the lowest quintile, QI, the increase is 8.8 percent in Sweden (and in Norway – after Belgium). For QII, the lower middle class, Sweden's increase for the share in income is the second highest with 6.5 percent (again after Belgium with 6.6 percent). Also, the shares of the higher quintiles in income decrease (QIV and QV), which also indicates redistribution: For QV, the decrease is around 12 percent and Sweden is only surpassed by Belgium.

[152] Mahler et al. (2013) argue that to measure the impact of taxes and social transfers on different income groups, the most effective study is to look and before and after government quintile group shares (p.147). Using data from the LIS database, other countries in the study are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, the Netherlands, Norway, Sweden, Switzerland, UK and the US.

Table 19. Mean pre-and post-government quintile group income shares in Sweden

Sweden	QI	QII	QIII	QIV	QV
Pre-government shares	1.3	8.9	18.6	26.8	44.4
Post-government shares	10.0	15.5	19.0	22.9	32.6
Redistribution by share	8.8	6.5	0.3	-3.9	-11.8

Source: Adapted from Mahler et al. (2013), p. 148 using data from the Luxembourg Income Study database

8.4.6 Summing it up: decentralization, fiscal and social policies and inequality and what remains unexplained

In order to apply the theory of the dissertation, the previous sections first aimed at explaining the territorial governance structure in Sweden and then its transformations. Then, I presented national and regional income inequality figures, followed by a discussion of the welfare state and the fiscal and social policies that matter for inequality.

In conclusion, relating the information in this section to the theory, Sweden's highly centralized steering of fiscal policies within the system of local self-government still are redistributive to a large extent, despite increases in inequality after the 1990s, as figures indicate. The fact that "independent local political systems" has not emerged can also be regarded as a sign that Sweden's centrally coordinated financial equalization system overpowers the decision making power of local governments while allowing their autonomy in policy implementation. Furthermore, the fiscal flows have been reformed by the central government in 2005 to allow equalization in the decentralized structure, and the amount of redistribution has gradually increased, although the ensuing period is also marked by rising inequality. If we operationalize interactive governance by the shared rule components of *law making*, *executive control*, *fiscal control*, *borrowing control and constitutional reform* – as in the statistical study of this work -, Sweden would not have high interactive governance. There is especially a decrease in *borrowing autonomy* and the *fiscal control* of the county councils. However, interactive governance is not only limited to intergovernmental affairs between different levels but also emphasizes the roles of social actors in policy-making, which is not measured by the Regional Authority Index. Thus, the next section on interactive governance will focus on both intergovernmental relations and the social actors related to matters on inequality.

Against the backdrop of the retrenchment of the welfare state in general, as mentioned earlier, changes in unemployment policies are linked to rising inequalities (Fritzell et al. 2014). However, the authors fail to identify an "unambiguous" variable or trend to associate with increased income inequality. Due to such ambiguity concerning the determinants of increasing inequality, it is important to restate the correlations between the main variable of the dissertation, decentralization, and inequality.

To apply the theory of the dissertation, we can analyze the changes in the Regional Authority Index (RAI), as well as qualitative information about decentralization and fiscal and social policies. The changes in RAI do not reveal a very significant link with changes in income inequality in Sweden. The most important changes in this index are the increase in *policy scope* after 1970 and the decrease of *borrowing autonomy* of the county councils after 1970, and the decrease in *fiscal control* in the 1971- 2006 period.

According to the theory, *policy scope* (determining taxes) would be associated with more decentralization as it is a *self-rule* component of the index. After 1970, Sweden witnesses a decrease in net inequality, only to peak in the middle of the 1980s, followed by a decrease, until an increase again in the 1990s. The decrease again in the early 2000s is followed by an increase as of the middle of the decade. To test the argument of whether decentralization brings more inequality, we can say that the decentralizing reforms of the 1970s are followed by an increase in inequality in Sweden. However, it is hard to establish a dynamic link between an increase in the independent variable and the dependent variable in this case.

According to the theory, *borrowing autonomy* is associated with more decentralization as it is a *self-rule* component, and therefore I expect a decrease of *borrowing autonomy* of the 2000s to be associated with more income inequality, which is the case in the latter half of the 2000s. One can argue that the fiscal equalization reforms of 2005 onward first correlate with an increase in inequality, but they might also have contributed to the slowing down or the reversal of increases in income inequality as of the early 2010s (Solt 2016). 2005 is when inequality starts increasing sharply in Sweden, but one should keep in mind that the Gini coefficient does not change very quickly.

The numerical decrease in *fiscal control* in this index is for the whole period of 1971 – 2010, and there is a fluctuating trend of income inequality during this period. Yet, one can say that a sustained decrease in fiscal control might be associated with rising inequality, and higher fiscal control, if implemented would be conducive to lower inequality. To recall, the *Riksdag* restricts regional and local spending has since 1982, therefore the score decreases to 0 for the latter period of 1971 - 2010 (Hooghe et al. 2016, p. 156). If we look at inequality specifically after 1982, we see that a decrease in *fiscal control* correlates with an increase in income inequality around mid-1980s, which is in line with the theory of this work. Yet, this is not a continuing trend.

How can we account for what remains unexplained in the case of Sweden concerning decentralization and inequality? From the quantitative and qualitative evidence, it seems clear that rather than a very strong dynamic impact, there is a significant impact of the territorial governance structure in general on how Sweden remains as a low inequality country. This is also caused by the fact that it is a consensus and deliberation democracy with carefully designed policies that grant local autonomy to its subnational units. To apply the second part of the theory of this work, the next section brings in the argument of interactive governance, in order to test its impact on income inequality, against the backdrop of the changes in the territorial governance structure, such as decentralization and regionalization.

8.5 INTERACTIVE GOVERNANCE: INTERGOVERNMENTAL INTERACTIONS, SOCIAL ACTORS AND WAGE BARGAINING AND BEYOND

"**Sweden is characterized by its powerful interest organizations, dominant social democracy and egalitarianism…The consensus culture provides a framework for peaceful procedures for conflict resolution. Existing conflicts have tended to be uni-dimensional, along a left-right or labor-capital divide, which has facilitated their resolution."*** (Lidström 2010, p. 264).

As the abovementioned quote indicates, the governance in Sweden is not prone to conflicts that cut across more than one dimension. The labor-capital conflicts have largely been resolved through the institutionalized relationships emanating from the corporatist legacy. The corporate pluralist system has historically been a very significant feature of Sweden, and continues to be even when corporatism has waned in some other systems in Europe. The interactive process is occurring at all levels of government, even during what can be called a decline of corporatism.

In Sweden, the relationships between the government and the social actors have traditionally been of crucial importance for economic outcomes, especially in terms of wage bargaining or other welfare state policies related to inequality, such as unemployment policies. Wage bargaining institutions themselves are explanatory of pay inequality (Beramendi and Rueda 2014), which impacts the overall national inequality levels. Therefore, examining the roles of the trade unions and other similar social actors in the wage bargaining process is explanatory and serves to understand the nature of interactive governance in Sweden.

The inclusion of social actors makes Swedish governance more **interactive** than other countries examined in this work, such as Spain or France, based on their involvement in the policy-making process. The key role of the social actors in the welfare state has implications for interactive governance, since interactive governance is defined by "*the complex process through which a plurality of social and political actors with diverging interests interact in order to formulate, promote, and achieve common objectives by means of mobilizing, exchanging, and deploying a range of ideas, rules and resources*" (Torfing et al. 2012, p.14). Interactive governance is **decentered** since the common objectives are "*formulated and achieved in and through negotiated interaction among a plurality of actors from the State, the economy, and civil society*" (p.15), which is reflected in the decentralized features of the Swedish governance – which also feeds from the unitary setup. Therefore, I take Sweden as an example of interactive governance where there is a decentered governance structure with **vertical** and **horizontal coordination** steered by the central government. While the influence of trade unions – as the most relevant social actors - on policy making has decreased over the years, the organizational nature of the wage bargaining policies helps understand both the level of centralization/decentralization, as well as interactive governance.

8.5.1 Intergovernmental relations and interactive governance in Sweden

Before examining the involvement social actors, it is important to examine the intergovernmental relations aspect of interactions that matter for redistributive matters, including vertical and horizontal political coordination. Even in unitary and very centralized states – Sweden does not fall into that category due to its unitary and decentralized structure - , subnational governments need to have an extent of autonomy for decision-making and unitary regimes face the same type of necessity to have coherence in their implementation (Peters 2015). The Local Government Act of Sweden has an emphasis on the horizontal interactions concerning how the budgets of local governments are made. As stated in Chapter 8, Section 4:

"*Municipalities and county councils shall draw up, every year, a budget for the next calendar year (fiscal year). The budget of a common committee is drawn up by the municipality or the county council, which appointed the committee. The budget shall be drawn up following consultations with the other municipalities and county councils participating. The budget shall be drawn up in such a way that income exceeds expenditure*".

The so-called "weakening" of the central state institutions as of the 1990s remains as an important sign of the move toward decentralization, and this effect goes both ways. However, this decentralization also occurred alongside the encouragement of the central government for more cooperation between different levels and also public-private partnerships. Also, as Lidström (2010) explains, the private co-funding of public services such as health care or education are not permitted, which also led to more cooperation (as well as competition) among the local authorities to provide these services.

Moreover, the fact that the central agencies and boards take their orders not specifically from their ministers but from the whole cabinet can be regarded and that the Swedish agencies are among the most independent (Dahlström and Pierre 2011; Dahlström et al. 2011) can be regarded as contributing factors to more interactive governance in Sweden. Most of the central government activities are conducted by the 370 semiautonomous agencies, and local governments provide most of the social services (Pierre et al. 2015). Also, the collective decision-making and the joint preparation procedure (*gemensam beredning*) principles ensures that all the relevant ministries participate in the decision-making (Persson 2016).

The fact that the public employment agencies were originally not an instrument of the central government but of local authorities points out to the decentralized origins of certain features of the welfare state, which then became more standardized in the way labor and employer interests were observed (Rothstein 1996). As specified in the interviews, local boards and agencies are important in disseminating the unemployment insurance and they have bureaucratized in the recent years. Sweden has also been trying to strengthen the coordination capacity of its central government offices, a quest that dates back to the interwar years to better understand and improve the government procedures in general (Elder and Page 2000). Persson (2016) argues that the influence of Prime Minister's office and the Ministry of Finance have grown over time in terms of their overall coordination leverages. Another central government coordination strategy has been the appointment of 32 national coordinators utilized by ministries of the government offices, indicating a more "non-traditional, horizontal form of governance" for solving more complex policy problems (The Swedish Agency for Public Management 2014). Sweden has cabinet committees responsible for certain policies where departmental ministers are able to coordinate activities, especially important for the budget process (Peters 2015).

The creation of the regional developmental councils is regarded as an attempt by the government to boost horizontal coordination among the subnational units especially in matters related to development. Again, an intertwinement of national strategy with local autonomy is observed. Whether further regionalization in terms of mergers of regions will occur remains to be seen, and the most important issue at stake seems to be the delivery of healthcare. As Niklasson (2016) explains: "*This horizontal coordination is a kind of decentralization of national government which gave an extra boost to devolution by providing the elected regional politicians with more room to influence and coordinate the national agencies*" (p. 409). **Figure 32** below is a stylization of coordination in Sweden, which features collaboration and networking between regional developmental councils, country administrative boards and national agencies, contributing to more of both horizontal and vertical coordination. In the long run, the unfolding of the coordination structure can impact whether regional or national development strategies will overpower one another, or whether they will be undertaken in an interactive manner, which could have a substantial impact, especially on regional inequalities and the way the overall growth and development strategies are created.

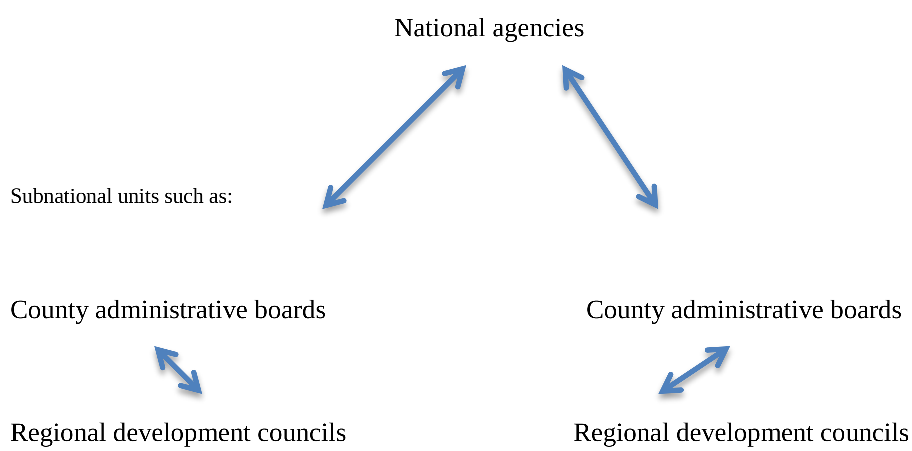

Figure 32. Coordination directions in Sweden

8.5.2 Social actors and interactive governance in Sweden

To complete the assessment of the relationship between interactive governance and inequality, it is important to look at the changes in the influence of trade unions in wage bargaining and related matters, as well as the decentralization of wage bargaining.

Öberg (2016) argues that despite the fact that institutional participation in policy-making has lessened in Sweden, the influence of social actors has not vanished. Yet, Sweden's corporatist structure is becoming somewhat more pluralist since the organizations do not have the same policy-advocating role as they did before, and they have more unclear membership bases than they would in a corporatist system. Unionization is strong in Sweden, but trade union density has been on a steady decline. According to OECD figures of 2013, trade union density - the ratio of wage and salary earners that are trade union members, divided by the total number of wage and salary earners – in Sweden is 67 percent, whereas it was 80 percent in 1999. However, this rate is still much higher than other countries, such as France, with approximately 7 percent, and Spain and Germany both about 17 percent (OECD 2015). Sweden is regarded as an example of encompassing "unionism" (Davidson and Emmenegger 2012; Obinger *et al.* 2012; Palier and Thelen 2012).

As the involvement of social actors renders a country's governance more interactive, the following quote encapsulates why Sweden can be considered as an "interactive governance" country in general:

"*Powerful, all-encompassing, and centralized trade unions that, usually in liaison with a governing (or governable) labor party, were willing to engage in central national-level, or industry-wide, negotiations with employers. This institutional matrix was based on labor's recognition of the rights and prerogatives of private industrial ownership, implying that neither unions nor labor governments would interfere with decision-making of private firms.* ***Conflicts were therefore limited to issues of how to distribute the social product***" (Esping-Andersen 1990, p. 164-165).

The reliance on social actors in welfare state policy making has been solidified as a result of a decades long consensus tradition. Lidström (2010) argues that "*the consensus culture has also left its imprint on Swedish labor relations. The trade unions that emerged with industrialization became strong and centralized, and employers organized themselves in a similar fashion"* (p. 264). As Esping-Andersen (1990) explains, what has existed in Sweden, at least until recently, was centralized and solidaristic trade-union organization in political harmony with government policy; and employer confidence and willingness to sustain high investment levels. Steinmo (2013) argues that there is "*a symbiotic relationship developed between the organizations representing big business and big unions, and these also tolerated a powerful state*" (p. 87). During the interviews, one interviewee explained the current state of the decentralized and interactive wage bargaining process with the state participating when necessary, as follows:

"*In Sweden, minimum wages are not governed by law, but by collective agreements – taken with social partners in Sweden. The state usually keeps its hands away in wage formation. If partners cannot agree, then they mediate. The state has an active role if the negotiation partners cannot reach a settlement. It has a proactive role in that respect. The parliament decides on the wages with the unions and the employers together. They negotiate with each branch"* [153].

Thus, we can argue that the corporatist system in Sweden has transformed to a version of itself that is still favorable to achieving standardization of economic outcomes. Öberg (2016) argues that the Swedish welfare state, which includes the tax system, is a reflection of the power relations between the employers and the trade unions. As Lindvall and Rothstein (2006) explain, the policy making process in the welfare state has generally been "consensus" based and usually proceeds as in the **Figure 33** below.

[153] Personal interview, Gothenburg, Sweden, March 2013.

Politicians at the national level & leaders of major interest organizations

Government commissions of experts gathering information

(MAJOR INTEREST ORGANIZATIONS participate)

↓

Politically feasible proposal to the Parliament

↓

Civil service departments implementing & local governments put into effect

(MAJOR INTEREST ORGANIZATIONS participate)

Figure 33.Welfare State Policy Making in Sweden

Source: Adapted from Lindvall and Rothstein (2006), p. 49

In a more recent work, Öberg (2016) argues that in the 1990s all the relevant interests were involved in the decision making process at the commissions of inquiry stage. But with the importance of the commissions decreasing, now the interest groups are involved in the advisory boards and they do not get a chance to “confront” other groups in open discussions, showing a decrease of interest group involvement in general. Similarly Öberg and Svensson (2012) state that most of the contact of the interest groups is now conducted through the mass media and direct contact with the politicians, rather than open debates, but this does not necessarily mean that there is not an active civil society in Sweden anymore. At the Parliament stage, some members of the parliament are those that have been active in the civil society.

If we look at policy concertation from the territorial governance perspective, concerning the decentralization process of wage bargaining, an interviewed expert claimed the following[154]:

> *"The norm is for the exporting sectors to make the wage increases, as Sweden is dependent on exports. If you let partners of domestic market determine the level, they can make that quite high: They argue that they would lose competitive power and this would result in a job loss. Then it is followed by services. In the service sector the wages are more equal and there is more central agreement. The third step is negotiation at the local level with individual wages and salaries. While the central level is very strong, at the local level, with every employer there is an affiliated agreement. Central collective agreement gets the lowest level".*

Therefore, the centralization of wage bargaining now occurs more at the sectoral/industrial level rather than at the national level. Information from the interviews are similar to the findings of indices on Sweden's wage bargaining. If we look at quantitative indicators and classification of wage setting/bargaining coordination of Kenworthy (2001) we see that Sweden gets a score of 3 in a range of 0 to 5, for 1994 onward (until 2001). This score is explained as follows: "Industry-level bargaining with somewhat irregular and uncertain pattern-setting and only moderate union concentration". If we look back at an earlier period, for the period of 1960 – 1982, Sweden's score was 5: "Centralized bargaining by peak confederation(s) or government imposition of a wage schedule/freeze, with a peace obligation". In the "*Data Base on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts, 1960-2014*" (Visser 2015), we can also observe a change in the coordination of wage-setting procedures. From 1960 until the mid 1990s, Sweden has a score of 5, indicating:

"a) centralized bargaining by peak association(s), with or without government involvement, and/or government imposition of wage schedule/freeze, with peace obligation,

[154] Personal interview, Gothenburg, Sweden, March 2013.

b) informal centralization of industry-level bargaining by a powerful and monopolistic union confederation,

c) extensive, regularized pattern setting and highly synchronized bargaining coupled with coordination of bargaining by influential large firms".

In the mid 1990s, Sweden's wage setting coordination score decreases to 3 in this index, which indicates that there are "*negotiation guidelines based on centralized bargaining by peak associations with or without government involvement, informal centralization of industry-level bargaining and government arbitration or intervention.*" However, after the mid 1990s, Sweden's score increases again to 5, remaining the same until the last year examined in the index, 2014.

If we want to examine the centralization level of wage bargaining looking at union authority and concentration at different levels, this database offers some useful information as well. We see a decline in the centralization score of Sweden: (measured on a scale of low centralization – 0 - to a high centralization – 1-). In 1960, the score was 0.593, whereas in 2014, the centralization level was 0. 523.[155] This variable weights "the degree of authority or vertical coordination in the union movement with the degree of external and internal unity, and union concentration or horizontal coordination, taking account of multiple levels at which bargaining can take place and assuming a non-zero division of union authority over different levels" (Visser 2015). This information should be considered taking into account the fact the authority of the government for corporatist relations is also not the same as before due to various reasons, such

[155] The centralization score has increased slightly in the recent years from the lowest point of 0.507 in 1983. The slightly more decentralized wage bargaining scores of 1980s correspond with lower inequality levels in 1980s compared to current times, but it is difficult to attribute direct causality.

as Europeanization, liberalization of capital flows and the independence of the Central Bank of Sweden (Öberg 2016, Öberg et al. 2011).

To understand the nature of wage bargaining in Sweden and how it has contributed to interactive governance over the years, it is also useful to look at the evolution of the role of social actors in welfare state from a qualitative perspective. The bipartite Saltsjöbaden Agreement of 1938 proved that employers and unions accept the legitimacy of each other in an organized fashion, carrying on to the 1950s as well (Compston 2003). The key idea behind this agreement, which as Pierre (2016) states is still in effect, is that the state should be a mediating actor in wage bargaining, rather than directly interfering, and that the social actors should have autonomy.

The labor market program of those times was in harmony with the objectives of the employers and it was argued that the active labor market policy was "employers' ally" (Swenson 2004). According to Compston (2003), the period between 1930 and 1992 was a **high concertation** period according to the frequency, breadth and duration of national-level policy concertation. He argues that a "*combination of top-level negotiations, representation on executive agencies and participation in policy-making commissions*" marked this period.

After World War II, unions and employers had jointly regulated the labor market and the general trend was central regulation and wage bargaining. Representatives of LO (Swedish Trade Union Confederation), SAF (Swedish Employer's Confederation) and SAP (The Social Democratic Party) used to meet regularly concerning the general directions of the economy as well, pointing to the **social corporatism** of Sweden. Something that enabled this system was that the electoral system was created in a way that necessitated the social partners to keep in power, so Sweden exemplified politics of "compromise" as coined by Rustow (1955) (Steinmo

2013). Esping-Andersen explains the 1930s-50s Swedish welfare state by highlighting the centralized trade unions that were in liaison with a governing labor party – that would engage in central national-level, or industry-wide, negotiations with employers (p. 164). This social corporatist structure did not mean that all parties were always on the same page: In the 1970s and 1980s the government, the unions and the employers disagreed in their economic views leading to deadlock in policy concertation (Compston 2003). The blue-collar associations were the most important employee organizations in the 1960s and 1970s and the decentralizing trend of the associations is also correlated with the rise of white-collar associations (Iversen 1999).

The pattern of unionization changed from 1970s onwards in Sweden due to changing economic conditions. "*Explicit bargains took place in Sweden in 1973, when unions agreed to moderate wage claims in return for a legislated abolition of employee pension contributions*" (Esping-Andersen, 1990, p. 175). In 1971 and 1974, legislation on job security was passed. In the 1990s, with high unemployment figures, SAP had to be on board for more flexibility in the labor market. At this time, SAF wanted more deregulation in job security for the workers.

The trade union influence in Sweden has gradually become more decentralized over the years, which also impacted its influence on wage bargaining. Between 1968 and 1983, the unionization rate had increased sharply and unions gained more power to influence the wage distribution. Albrecht, Björklund and Vroman (2009) mark 1983 as the year when the centralized nature of wage bargaining started to decrease, when the Swedish Metal Workers' Union (a union in LO) made a separate agreement with the Swedish Engineering Employers' Association (an association within SAF). Afterwards, between SAF and LO, wage bargaining progressed without central coordination. It is important to note that the national unions are actually responsible for local bargaining as well, but the subject of that local bargaining can only cover the industry-level agreement (Kenworthy 2001).

While the trade union influence was encompassing many sectors until 1992, after that date the influence has been restricted to labor market policy and pensions. As of 1992, the policy concertation has changed, since lay members who were selected by the central government due to their expertise replaced the union and employer representatives involved in the decision making process when the center-right Bildt government came to power (Compston 2003), corresponding with times of higher income inequality in Sweden.

In the retrenchment period of the 1990s, there were broad "consensus" patterns among Conservatives and Social Democrats for these packages, which indicates more interactive governance with a move towards common goals on possibly divisive issues. In 1996, the legislation was accepted only when it fit the union demands to have more security when workers changed jobs. Besides reductions in protection for permanent workers, French and Swedish reforms have included reassurances concerning protection for permanent workers, increasing the benefits for the insiders (Davidson and Emmenegger 2012). Due to high unemployment, the unemployment insurance had to be restructured (Bergh and Erlingsson 2009) and "*decision making was characterized by antagonistic interests and a power struggle between the trade unions and the political parties*" (Obinger et al. 2012, p. 191). It is argued that while the benefits between the two tiers of unemployment protection in Sweden are getting similar, there is not enough coordination between the two tiers (Lindvall and Rothstein 2006). As social partners, LO and the Trade Union Confederation represent interests of pensioners as well workers with wages who are contributing to the system. Therefore, in Sweden, since benefits in the basic pensions are related to the benefits, the LO is concerned about the wage levels, current and future pensions (Anderson 2001). For that reason, it is argued that the unions, deliberately, have not prevented real-wage decline in Sweden: "*Sweden's tax-extractive capacity is both unique and intimately related to the solidarity that supports the welfare state and full employment... the government has been able to rely on the unions to sacrifice wages for the sake of the common good since 1982, but the ensuing real-wage decline has also triggered a growing unrest within the labor movement"* (Esping-Andersen 1990, p.183-184).

The close link between union membership and unemployment insurance gives the trade unions which are closely linked to the SAP an important position in social and labor policy-making. Accordingly, the Swedish welfare state has produced a status of high equality among citizens, realized through generous universal social benefits, training and employment based active labor market policies and high levels of public employment (Obinger et al. 2012).

Going back to the issue of insiders versus outsiders of the market, it is argued that industrial relations in Sweden have become less centralized and more adversarial and that the weakening of leftist corporatism has had a dualizing effect, emphasizing insider-outsider relations more than before **(**Obinger et al. 2012). Lindvall and Rueda (2012) argue that conflicts between insiders and outsiders are less likely to be intense in Sweden because "*Swedish labor market institutions can be expected to promote solidaristic policies that bring together insiders and outsiders*" and the relatively centralized nature of the trade unions and employer organizations, which is one of the items that make governance more interactive (p. 280). They base this argument on Olson's (1965) argument that "encompassing interest organizations are more likely to take general goals into consideration than organizations representing more narrowly defined groups", indicating higher interactive governance. Furthermore, a *Västra*

Götaland interviewee pointed out to the inclusion of social actors in EU level policies: *"In the implementation of ERDF and European territorial cooperation (cross-border cooperation), the labor market representatives are always invited to the talks*". Concerning the importance of the EU in this process, the expert claimed the following[156]:

> "*Agreement between company and the local unions (minimum wages) is regulated by collective agreements, not law, while the EU Commission actually wants this to be regulated at the law level. The EU is OK with this if you can prove this is covering the whole labor market al.so about 92 percent of the agreements are affected by EU directives".*

According to one of the interviewees, the current situation of the wage bargaining system after the 2000s in Sweden is as follows:

"The social actors, such as trade unions, have an active role in determining the wages first at the central and then at the local level is in coordination with the state, although the organized social partners are losing control over wage formation in recent years. At the local level, firms and municipalities have more leverage, which leads to more discrepancies. Organized social partners will lose control over wage formation."[157]

Thus, it is to be seen whether the increasing impact of horizontal coordination will come at the expense of the roles of the social actors in this process. In addition to the trade unions, the Swedish Association of Local Authorities and Regions (SALAR), which represents the interests of subnational governments, is an important player in local – central relations. It is also viewed as a "mediator" between different levels and is argued to have contributed to shaping the sharing of competences between different levels (Feltenius 2016). For example in health and medical care, the central government creates the main principles, guidelines and the political agenda with

[156] Personal interview, Gothenburg, Sweden, March 2013.
[157] Personal interview, Gothenburg, Sweden, March 2013.

SALAR. As the official Sweden website states: *"It (the central government) does this through laws and ordinances or by reaching agreements with the Swedish Association of Local Authorities and Regions (SALAR), which represents the county councils and municipalities."*[158]

In addition to income inequality, wage inequality figures are also informative in understanding economic inequality in general, especially in the case of Sweden, as showcased earlier in the chapter. To this end, understanding of wage agreements within the framework of policy concertation is important. Albrecht et al. (2009) examined how wages in Sweden were distributed in the period of 1968 - 1981 and then 1981 - 2000. They argue that the centralized wage agreements marked the first period with "strongly equalization clauses" but the latter period enabled more firm-specific factors that could affect the wages. The finding is that the first period witnessed more "wage compression", while the second period saw uniformity in wage growth. The wage compression between 1968 and 1981 was driven by changes in the distribution of returns, but between 1981 and 2000, the change in the distribution of returns was neutral with respect to inequality (Albrecht et al. 2009). The first period was characterized by a dramatic equalization of wages and the second by a weak increase in inequality, overlapping with the introduction of more decentralized wage bargaining. The decrease of the wages of the upper quartile of workers is attributed to a solidarity wage policy. Nevertheless, since currently the bargaining is usually at the industry level (or even plant level), there is not much coordination across industries, paving the way for differentiated wages because factors that are specific that industry or firm can impact the wages: "*Although contracts often stipulated a guaranteed absolute wage increase for all workers, and hence higher relative wage increases in*

[158] Healthcare in Sweden, https://sweden.se/society/health-care-in-sweden/

the lower end of the wage distribution, the special low-wage settlements that characterized the central frame agreements were no longer used" (Albrecht et al. 2009, p. 6).

8.5.3 Relating it back to the theory: decentralization, interactive governance and inequality in Sweden

Relating this information to the theory, in sum, Sweden's constitutionally unitary territorial structure is organized in a way to allow local autonomy in service delivery and some extent of tax authority, but not fiscal control. However, this does not necessarily indicate low interactive governance, based on the qualitative evidence on Sweden. Mergers of territorial layers aim at better delivery of policies to citizens, therefore centralization and decentralization occur at the same time. The centralized wage bargaining has been replaced with a more decentralized and industry level wage bargaining, but this replacement has been done in a standardized way throughout the country with the inclusion of social actors, contributing to classification of Sweden as an interactive governance country in this work. Nevertheless, the fact that wage bargaining is conducted at a more decentralized level with a less institutionalized framework in a de-corporatizing Sweden can lead to wage discrepancies among sectors, as discussed above. In fact, differentiation of wages throughout the country and changes in unemployment policies are regarded as determinants of rising inequality in Sweden, along with the market forces that are in effect. Yet, attempts for strong vertical and horizontal coordination, semiautonomous agencies and its consensus based deliberative democracy prove the existence of higher interactive governance, despite the fact that there is no fiscal shared rule in Sweden, as stated earlier.

Sweden's increase in inequality in the 2000s is not directly explained by changes in its territorial governance structure, such as decentralization, centralization or regionalization. However, regionalization is argued to be associated with variances across the country in terms of development and capacities of the subnational units, especially considering geographical differences, which is targeted by the European Union funds.

Despite increases in the 2000s, Sweden has maintained its place in the low inequality countries in Europe and in the world, however, it remains to be seen whether economic conditions, the regionalization process facilitated by the EU, changing coordination practices, as well as reforms on welfare state policies (such as income equalization practices, tax reforms, unemployment policies or integrative policies in health care) and the weakening of the corporatist structure will change this categorization. Whether the centralized nature of the reformed (horizontal) economic equalization system in decentralized Sweden will achieve its goals needs careful attention. High *fiscal autonomy* of the county councils of Sweden has not changed in the time period of this study (with a constant score of 3 out of 4), and therefore its impact on inequality is not studied from a dynamic perspective. Yet, its existence of *fiscal autonomy* and high *revenue decentralization* should not be overlooked. However, the possible inequality increasing impact of high *fiscal autonomy* in Sweden is offset by its high interactive governance system to a large extent; and in line with the theory of this work, one can say that Sweden's inequality is still low. Coupled with the equalizing principles of the universalist welfare system (despite retrenchment), Sweden still has high levels of redistribution, which is conducive to lower inequality. If these principles were to change, impacted by less involvement of social actors in wage bargaining, more wage differentiation or more varied fiscal and social policies, it could signal increasing inequality in the future.

The table below showcases the interactive governance index of Sweden, constructed with information from this chapter with my own elaboration. The interactive governance of a country is enlightening because it allows me to take into account both intergovernmental relations and the involvement of social actors while keeping in mind decentralization, centralization and regionalization. The chapter that will compare the findings of the four cases of my typology will further show the extent to which I find evidence for my theory in different contexts, and compare the interactive governance indices of the four countries.

Table 20. Interactive Governance Index of Sweden

Processes	**0 Low Level**	**1 Medium level**	**2 High level**
Identifiable goals – concerning equality in tax capacities and social policy delivery			X Commitment of the political culture to 'egalitarianism'
Vertical: Clear and observed rules of relationships between each subnational government and the central government		X Certain overlaps in the territorial governance structure Mergers versus more decentralization: Some uncertainties for the future	
Vertical interactions (mutual contingencies and interdependencies between different levels)		X (Reliance of subnational units on the central government for common tax coordination & decentralized implementation and service delivery	
Horizontal interactions: Central government's capacity to coordinate among its departments & interactions among different layers		X Strong government that governs as a whole rather than through the ministries, semi-autonomous agencies	
Relying on social partners and compromise			X Example: Inclusion of social actors (e.g. unions) in wage bargaining despite decreases Consensus based system
Harmonized and integrated policies at various levels			X
Outputs **Goal attainment and distributional effects**			
Institutionalization and dissemination of revenue collection with equalizing effects			X Economic equalization system reformed in 2005
Systemic approaches to governing at different levels		X Vertical and horizontal coordination mechanisms and capacities being improved	

9.0 THE COMPARISON OF THE FOUR CASES AND MAJOR CONTRIBUTIONS

This concluding chapter aims to summarize and compare the findings of the case studies of the dissertation, and put the findings into a comparative perspective. In light of my theory, I aim to compare the extent to which I find evidence for my theory in the cases of this dissertation, Spain, Germany, France and Sweden, which are the countries in my typology, as summarized below.

How do the two federal states, Spain (*de facto*) and Germany; and the two unitary states France and Sweden, vary in terms of the extent to which decentralization and interactive governance impact income inequality? One of the distinctions when testing the significance or the magnitude of impact of (fiscal) decentralization on income inequality is whether one should apply a dynamic or a static approach. In other words, from a dynamic perspective, do the changing inequality levels match the changing decentralization levels in these countries? Or, from a static perspective, do the constitutional principles that lay out the territorial governance and practices emanating from these principles impact income inequality in general? Income inequality, measured with the Gini coefficient, is a variable that does not change too often. For this reason, a general static perspective that examines and compares the constitutional principles concerning the regional organization of power and intergovernmental relations ensuing these principles can allow us to examine income inequality as well.

In this chapter, I will first look at the impact of regional organization of power in general on income inequality, from a static perspective. For example, the sharing of competences among territorial levels and the way "fiscal federalism" principles or the fiscal equalization systems are applied are important factors that lead to policies with significant impact on inequality. Then, I will apply a dynamic approach and compare whether and to what extent the decentralization processes have a dynamic impact on inequality in these four countries. After answering these questions, I will also present and compare the interactive governance points of these four cases, which are based on my own elaboration, reflected in the Interactive Governance Index of each country, with the information presented in the case studies.

To recap the argument of the dissertation, I argue that more decentralization, and especially fiscal decentralization, is associated with more income equality, but I expect (high) interactive governance to be significantly associated with lower income inequality. If a country has interactive governance, this can offset the inequality inducing effects of decentralization, and conversely, if a country has less interactive governance, this would be associated with higher inequalities. This dissertation contributes to the literature on federalism, decentralization, governance and inequality in both theoretical and empirical ways. First of all, I disentangle the political, administrative and fiscal aspects of decentralization quantitatively, using the Regional Authority Index, and qualitatively with the elite interviews conducted in the four countries.

Overall, the detailed case studies enable me to reflect on how the territorial governance structure impacts inequality both from a static and dynamic perspective through a) constitutional changes (federal or decentralization reforms) or b) fiscal and social policies. I complement my argument on how decentralization impacts inequality with how the interactions in governance can also add to or detract from decentralization's effect on inequality. I also consider interactive governance as a separate variable: This work allows me to measure interactive governance by disaggregating it into its processes and outputs through looking at its intergovernmental and non-governmental aspects, which brings a new applied method to understanding and measuring governance.

The table below is a reminder of the typology of my case studies. Then, I summarize and explain my case study findings further.

Table 21. Typology of the Cases of the Dissertation

Federal and high interactive governance Germany	*Federal and low interactive governance* Spain (de facto)
Unitary and high interactive governance Sweden	*Unitary and low interactive governance* France

9.1 STATIC PERSPECTIVE OF THE IMPACT OF DECENTRALIZATION: DOES THE TERRITORIAL GOVERNANCE STRUCTURE IMPACT INEQUALITY IN GENERAL?

In this section, I first summarize the results from the two federal countries of my typology, which differ mainly in their interactive governance levels but also the way their regional organization works. Furthermore, on the whole, Germany is considered a medium-level inequality country with lower inequality scores than Spain (with current Gini score of Germany around 0.29 and the score of Spain being around 0.33) despite drastic increases in recent decades. Therefore, the one general point is that a federal country such as Germany, with more centralized political and fiscal practices with higher interactive governance has lower overall national inequality than a country such as Spain, with again fiscally decentralized but a more asymmetric federal structure, and low interactive governance. Germany and Spain's territorial governance structures are both found to be important variables for distributional outcomes from a static perspective, but in distinct ways. As elaborated in the chapter of definitions, federal countries come in many shapes, in terms of their political, fiscal and administrative decentralization elements. I classify Spain as a *de facto* federal country due to its unique territorial governance structure that combines elements of a federal as well as a unitary state, with political and fiscal asymmetries resulting from this territorial governance structure. On the other hand, Germany is a federal country, referred to as "cooperative" or "unitary" federal in many sources among other classifications, as outlined in the case study on Germany.

On the whole, Spain and Germany's upper chambers, *Senado* (Senate) and *Bundesrat*, have different implications for the territorial governance in these two countries. Whereas the Spanish Senate is regarded as "the old second chamber of the centralized system" and does not ensure representation of the territories, the upper chamber, *Bundesrat*, operates on the principle of territorial representation and is an important veto player in decision-making. While this mainly has implications for the low interactive governance level of Spain and higher interactive governance of Germany, it also indicates how the federal principles are laid out in general. The less populated rural provinces are overrepresented in the Senate in Spain, and the majoritarian system reflects the interests of the central government. In Spain, there is absence of a German type of "institutionalized co-sovereignty" in its asymmetric federal structure (Beramendi 2012). While we see evidence for intertwined policy making of the central and regional levels with decades long cross-party cooperation (*Politikverflechtung*) (Scharpf 1976) in the case of Germany, regional parties and the varying centrifugal tendencies in Spain do not point to such cooperation. *Politikverflechtung* is also closely related to the horizontal fiscal equalization policies. Overall, while there is an ongoing reorganization of regional powers in the case of Spain, Germany's federal structure follows more of a path-dependency (Lehmbruch 2000) despite the recent federalism reforms.

Regional organization of power has a crucial impact on the way policies are planned and implemented, both in federal and unitary systems. In the case of Spain and Germany, in terms of their fiscal policies, both countries are centralized in terms of the creation of these policies, and both are decentralized in the implementation of these policies. However, again it is important to highlight the powers of *Bundesrat* in Germany, as it has veto powers in laws that concern the territories. In the case of Spain, the delivery of most services rest with the ACs. Despite their overall high decentralization levels, both Germany and Spain have centralized fiscal equalization and taxing systems. In the case of Spain, the central government collects almost all taxes and redistributes them to the regions based on a formula taking into account the size of the region, the per capita income and the number of provinces in the region, which Encarnacion (2008) argues is in contrast to a real federal system. At the same time, in the fiscal decentralization process brought more autonomy to the regions in terms of administration of the taxes and more revenue autonomy, in contrast to the case of Germany. Yet, Spain's categorization in many sources and my interviews echo Colino's point (2008) that Spain has high dependence of its units on central funding (taking into account to exception of Navarra and Basque Country which are outside the general financing scheme). In Germany, the federal government is responsible for the general framework of the taxes, but *Länder* can collect the tax revenues. There is a joint tax system and a fiscal equalization system, which have been applied in conjunction with one another.

Here, it is important to cite again the comparison between the two countries in terms of the nature of their decentralization that concerns fiscal principles. According to Gordin (2009), Germany displays the characteristics of "cooperative decentralization", whereas Spain displays "collaborative decentralization", which can be more prone to fiscal and overall intergovernmental conflicts. According to Colino and Kölling (2014), Spain and Germany can both be considered in the same 'integrative' or 'cooperative' federal category in terms of their fiscal equalizations. In Spain, the subnational units share powers and revenues with the central government, and in both of these countries, the subnational units have the obligation of implementing federal laws and provisions. As research shows (Bosch 2011; Herrero-Alcalde et al. 2011) fiscal decentralization and the asymmetries that have emerged out of the fiscal equalization system in Spain are related to variations in income per person in the regions. At the end of the fiscal year, the revenues per person allocated to the poorer ACs, such as Extremadura, are higher than those in richer regions. This is one of the main points of evidence about how the decentralized governance structure in general is associated with more income inequality in Spain. Spain's fiscal equalization system has not totally been ineffective in the reduction of inequalities, yet more developed regions can provide better welfare for their citizens, sustaining the already existing inequalities that have been present for a long time – a legacy from the time of the "Eight Spains" (Linz and de Miguel 1968). In sum, the centrifugal tendencies emanating from these disparities sustain and contribute to the furthering of inequalities. As Ayala et al. (2009) show, the internal differences of the autonomous regions are explanatory of both regional and overall national inequality in Spain.

In Spain, overall, the territorial governance structure is significantly related to the redistributive policies with asymmetric results, which fall short of overcoming high national income inequality, and relatively lower, but still high levels of regional differences and regional inequality in Spain. Both Germany and Spain has fiscal equalization mechanisms and grants in place in order tackle interpersonal and regional inequalities. In Spain, the vertical Total Adequacy Fund, the horizontal Essential Public Services Fund, the Global Sufficiency Fund, the Convergence Funds, the Competitiveness Fund, and the Interterritorial Compensation Fund, which I explained in detail in the case study, are examples of vertical and horizontal equalization mechanisms. There are more explicit criteria in regional financing as of 2009 to overcome the arbitrary and over-equalizing procedures. Overall, there has been a decentralizing trend in government financing in Spain. In Germany, there are also various vertical and horizontal intergovernmental grants. In the 1990s, in terms of correcting the inter-regional differences in terms of income per person, the central government was able to reduce the regional income differences by 33 percent, which is slightly lower than that occurred in France at this time (38 percent). Germany's federal system tries to equalize revenue based on needs and there are highly progressive intergovernmental grants.

Equalization principles, which are associated with the territorial governance structure, are not found only in fiscal equalization schemes or intergovernmental grants. Again, to cite again one of the quotations from the interviews on this issue from the chapter on Spain, in the words of an interviewee: "*Spain and Germany are in the same box for fiscal equalization but Germany seeks to reach it culturally as well… There is a different 'commitment' for redistribution. And there are some unexplained cultural dispositions that distinguish these two* *countries."*[159] While I do not look at the role of political culture in this study, this highlights the significance of features that are implicitly behind the creation of these fiscal equalization mechanisms.

The nature of interactive governance can be regarded as a proxy of differing political cultures, which I will explore later in this chapter. Germany's unitary and compromise based (Hueglin 2013) political culture is distinct from the Spanish political culture which is nurtured by the dual or compound identities (Moreno 2001), rendering German politics more predisposed to cohesion and standardization, at least compared to Spain. While this is not the main focus of the study, it opens up avenues for further research.

Does the territorial governance structure of these two countries impact the way their welfare states function? Despite its decentralized structure and the implementation by the ACs, the Spanish welfare state is closer to a German *Bismarckian* system with centralized social security and redistribution, similar to the current welfare state of Germany. However, in terms of the outsider/insider divide (benefits for those inside and outside the job market, or those with typical or atypical jobs), the divide is sharper in the case of Spain than Germany. On the whole, there is not enough evidence on the causal impact of social service decentralization in Spain on inequalities. In Germany, the federal government's attempt to equalize regional differences and living conditions overall are conducive to lower inequality levels than found in Spain, despite increases in Germany in its overall national income inequality in the last decade.

When considering how redistributive Germany and Spain are in general, as two federal countries of this work, the redistributive impacts of their welfare states do not reach the same

[159] Personal interview, Madrid, Spain, January 2013.

levels as other unitary countries such as France or Sweden, especially in terms of interpersonal redistribution; and they can be considered as medium redistributive countries (OECD, 2008; Mahler et al., 2013). As Mahler et al.'s research (2013) shows, in Germany, taxes and transfers caused a reduction of 39 per cent inequality between 1981 and 2006, indicating a medium level of income redistribution, which was between 40 and 50 per cent in Scandinavian countries, including Sweden.

After the two federal states, now I turn to the summary and the comparison from the two unitary countries in my typology, Sweden and France. Sweden is a unitary state with interactive governance, which is classified among the "low inequality" countries in the OECD, along with other Scandinavian countries[160]. Its current Gini score is around 0.27, leading to its classification as a low inequality country in most sources. Sweden's highly centralized steering of fiscal policies within the system of local self-government and its "decentralized unitary state" is still redistributive to a large extent, despite increases in inequality after the 1990s.

Sweden's centrally coordinated financial equalization system overpowers the decision making power of local governments while allowing their autonomy in policy implementation. Therefore, the high interactive governance of Sweden does not rely on shared fiscal power. Furthermore, the central government has reformed the fiscal flows to allow more equalization in the decentralized structure. Relating this information to the theory, Sweden's constitutionally unitary territorial structure is organized in a way to allow local autonomy in service delivery and some extent of tax authority, but not shared fiscal control. However, this does not necessarily

[160] Austria, Belgium, Germany, Hungary, Ireland, Luxembourg and Slovenia are classified as "middle inequality" countries with a P95/P5 between 4.77 and 6.61. Estonia, Greece, Italy, Poland, Spain and the UK are "high inequality" countries with a P95/P5 above 6.61 (Gyorgy Toth and Keller 2013).

indicate low interactive governance, based on the qualitative evidence on Sweden, and as its Interactive Governance Index also indicates.

I classify France as a unitary and low interactive country in my typology. France has undergone important decentralizing and territorial reorganizing processes, yet it keeps its overall fundamentally centralizing features despite more powers being allocated to some subnational units, such as the regional councils. While it is considered as low-interactive for the purposes of this typology, it has also undergone processes that render it more interactive over the recent years. Overall, France's very centralized tax and redistributive system has led to high level of territorial standardization, with aspects such as roughly equal spending per capita by the state and Social Security. The centralized nature of the territorial governance structure is significantly related to France's low income inequality nation status in Europe with its centralized and unitary system over the years, but with some hikes in recent years, the current Gini score has increased to about 0.30. The French welfare state impacts the income distribution, mainly through its centralized provision of resources, such as education or unemployment support. The redistributive system is based on state transfers, as well as local taxation. The centralized welfare state of France can be regarded as one of the reasons why the share of wages increased in the total income of France, and how that contributed to a reduction of inequality (Piketty 2014; Atkinson 2015). While the French taxes are regarded to be regressive and this characteristic can lead to increases of inequalities in the future (Fremeaux and Piketty 2014), overall, the redistributive system has led to a high level of territorial standardization. Yet, the territorial reforms of 1999 mainly aimed to overcome disparities resulting from state transfers that favored local governments. The transfer of competences of social policies to local levels can also be linked with higher inequalities in the future. Again, to assess the redistributive impact of the welfare state of France, the movement of income among the different income groups is also telling, in addition to the *Gini* levels. This is reflected in Mahler et al. (2013)'s study, which shows France as country where redistribution significantly does move people from the lower income quintiles to the upper ones, more so than what occurs in Germany or Spain. There is an overall centralizing trend in intergovernmental grant allocation. Yet, there are practices that move away from more standardized distribution, such as the mayors that have an office at a district level getting more discretionary grants than others (2015).

Comparing France to Sweden, the unitary fiscal structures show similarities, but these two countries mainly differ in the way they have embedded the local governments in policy implementation. Merely looking at quantitative fiscal autonomy or fiscal control scores is not telling because the fiscal autonomy of Swedish regions is higher than France or even a federal country, Germany. High fiscal autonomy does not necessarily mean also high fiscal control, which is a variable I use to operationalize interactive governance in the quantitative study. The fact that income inequality has not skyrocketed to the levels of many OECD countries can be attributed to the government's welfare state policies have embedded equality principles. In this respect, it is telling to look at territorial governance as a whole in Sweden rather than applying a dynamic perspective, but the main institutional structure behind these principles needs to be taken into account first. Also, exploring interactive governance is more revealing in the case of Sweden, which I explore in the next section.

On the whole, my interviews and extant research show that a country's territorial governance structure is related to inequality mainly through the distributive and redistributive practices and policies that are shaped by this territorial structure, as exemplified in the four cases. The territorial governance structure results centralized or decentralized principles, or those that combine elements of both. A static assessment of decentralization's impact on inequality is revealing, yet it does not tell us about how certain practices impacted inequality over time. Furthermore, looking at the current state of inequality, the fiscal principles in most of these four cases show centralized tendencies, especially in terms of the determining of the policies. Therefore, distinguishing between these of states with a more refined approach would necessitate a dynamic look in addition to a static one, as well as an comparison of their interactive governance. Next, I turn to this dynamic perspective of examining decentralization and inequality.

9.2 DYNAMIC PERSPECTIVE OF THE IMPACT OF DECENTRALIZATION: DO CHANGING DECENTRALIZATION LEVELS MATCH THE CHANGING INEQUALITY LEVELS IN THE FOUR CASES?

Do different periods of decentralization correspond to higher or lower inequality in these four countries? As stated earlier, in order to understand the dynamic impact of decentralization on income inequality, one can look at the time periods during which decentralization occurs, and the subsequent inequality levels, while keeping in mind that inequality (as measured with the Gini coefficient) is a variable that does not change too often.

First, I will look at decentralization from a dynamic perspective both in the case of Spain and in Germany. In the case of Spain, after the democratization process, the period of the harmonization of taxes and transfers (1987 – 1991) in the classification of Novo Arbona et al. (2016) does correspond to a decrease in inequality. Overall, in Spain, the period of the consolidation of the welfare state (1986 – 1995) saw reductions in inequality and poverty in Spain. As Ferrer-i Carbonell et al. (2014) also state, income equalization in this period is attributed to changes in the tax and benefits system. The period of 1991 – 2000 is classified in Novo Arbona et al. (2016) as the 'harmonizing' era where most of the political competencies of the regions were harmonized. As stated earlier and as the Regional Authority Index also shows, between 1997 and 2001, the ACs got more competencies in taxes, and in the following period, further financial equalization mechanisms were put in place. The latter half of 1990s sees a reduction in inequality, until the mid 2000s. OECD (2011) attributes the decrease in earnings inequality in Spain also to the growing economy. Looking at the evidence, it is possible to claim that more fiscal decentralization has occurred during the times of increases in Spanish inequality. Thus, one can argue that these financial equalization mechanisms are correlated with a decrease in income inequality in general. The increases in inequality after 2008 do correspond to more centralizing tendencies in Spain, yet it is difficult to attribute the changes in inequality to solely to centralizing tendencies, and economic recessions such as the one that took place in Spain, exacerbate inequality in general (Ferrer-i Carbonell et al. 2014). Therefore, in Spain, we can point out to matching levels of relatively higher fiscal shared rule – compared to before - (harmonization of taxes and transfers) with lower inequality, but with caution. This is because there is an overall medium level of fiscal decentralization, which has not drastically changed since the early days of democratization. Furthermore, the harmonization of taxes and transfers does not always necessarily denote a high level of fiscal shared rule.

In the case of Germany, we also do not see a very visible pattern of changing decentralization with changing inequality from a dynamic perspective. There is a decrease in the self-rule of the regions overall based on the Regional Authority Index (RAI), indicating a move towards more centralization (Hooghe et al. 2016), but there is an increase in the shared rule elements, with more fiscal and executive control and borrowing autonomy as of the 1960s, and more borrowing autonomy as of recently. The increase in shared rule can be regarded as an increase in interactive governance, however the changes in these indices are not substantial enough to warrant a dynamic link between changing decentralization levels and inequality. This is also due to the fact that no critical competences have changed in the recent federalism reforms, or before, and studies point out to the fact that these changes were not substantial enough to change the inequalities (Kaiser and Vogel 2016). Again, while certain competences have changed, this was expressed by one of the interviewees: *Germany was not actually going through decentralization "as a process"*. The changes in the employment structure and the dualization of the labor market were seen as important factors contributing to higher inequality in Germany (Biewen and Juhasz 2012), rather than changing decentralization levels.

Similarly, Sweden is a country that has decentralized over time with recent increases in its inequality. The changes in RAI do not reveal a very significant link with changes in income inequality in Sweden. The most important changes in this index are the increase in *policy scope* after 1970, a sustained high *fiscal autonomy* and the decrease of *borrowing autonomy* of the county councils after 1970, and the decrease in *fiscal control* in the 1971- 2006 period. To test the argument of whether decentralization brings more inequality from a dynamic perspective, we can say that the decentralizing reforms of the 1970s are followed by an increase in inequality in Sweden. However, it is hard to establish a dynamic link between an increase in the independent variable and the dependent variable in this case. Sweden's increase in inequality in the 2000s is not directly explained by changes in its territorial governance structure. However, regionalization is associated with variances in terms of development and capacities of the subnational units, especially considering geographical differences, which is targeted by the EU funds. In Sweden, against the backdrop of the retrenchment of the welfare state in general, as mentioned earlier, changes in unemployment policies are linked to rising inequalities (Fritzell et al. 2014). The decrease in the *fiscal control* of the regions, and this also correlates with an increase in the income inequality levels starting from the mid 1990s. *Fiscal control* is a part of shared rule dimension of regional authority, and I use it in the quantitative part of this study to operationalize interactive governance. So, applying the theory of the dissertation, less fiscal control (less shared rule and less interactive governance) correlates with rising inequality in Sweden. Furthermore, the fact that income inequality has not risen steeply to the levels of higher inequality OECD countries can be attributed to the central government's welfare state policies with embedded equality principles; observed throughout the country when the local governments implement them. One can argue that the fiscal equalization reforms of 2005 onward first correlate with an increase in inequality, but they might also have contributed to the slowing down or the reversal of increases in income inequality as of the early 2010s (Solt 2016). 2005 is when inequality starts increasing sharply in Sweden, but again, one should keep in mind that the Gini coefficient does not change very quickly. If we look at inequality specifically after 1982, we see that a decrease in *fiscal control* correlates with an increase in income inequality around mid 1980s, which is in line with the theory of this work. Yet, this is not a continuing trend. From the quantitative and qualitative evidence, it seems clear that rather than a very strong dynamic impact, there is a significant impact of the territorial governance structure in general on how Sweden remains as a low inequality country.

If we apply a dynamic perspective to the case of France, we see that both the regions and the departments have seen their powers shift over time. Overall there is revenue decentralization of the subnational units, but this authority is not matched in shared rule aspects. Overall, the self-representation of both the regions and the departments have increased, but in terms of the shared-rule aspects of regional authority, such as law making, executive control, fiscal control or constitutional reform, they do not have any power. There has not been very substantial fiscal decentralization (measured by fiscal autonomy scores), which could have led to higher inequality, despite the fact taxation is found to be the culprit of rising inequality. In France, recent mergers of territorial layers indicate both centralization and decentralization. The decentralization reforms of the 1980s coincide with increasing income inequality during that time, which suggests a dynamic correlation. The general non-progressive nature of taxation in France during that time, and the highest inequality levels were reached around that time. Again, France stands out among the OECD as one of these countries that did not witness a drastic increase in its inequality levels in the 2000s, which is a trend that reversed after 2010, making its current Gini level about 0.30. Also, France's public spending as a percentage of its GDP has been on the rise since the 1990s, reaching higher levels than those of Sweden, which has been considered as a contributing factor to sustained inequality levels of France, at least until very recently. In these two unitary countries, again, a dynamic approach of applying changing levels of decentralization to inequality should be approached with caution.

9.3 INTERACTIVE GOVERNANCE LEVELS OF THE FOUR CASES

Starting with two federal states, in the case of Spain, there is more emphasis on bilateral relations between the ACs and the central government than multilateralism, whereas Germany is marked more by its multilateral intergovernmental relations. Furthermore, the ambiguities in the Spanish Constitution concerning the relationship between the central government and the regions create room for asymmetry and bilateral relations to be sustained. The reliance of the regions on central government coordination is high, which is different from both a unitary and an actual federal state. As León Sanz (2013) specifies, "unity does not necessarily mean uniformity" in the case of Spain. Furthermore, regional party politics also allow for the differentiated development of the autonomy of the ACs.

Compared to more interactive states such as Sweden and Germany, Spain is considered as a low interactive state, but still also has interactive platforms at least at the intergovernmental level. Therefore, it is more suitable to call it a relative lower interactive governance state, rather than a non-interactive one. One important interactive platform in the literature, also frequently mentioned in my elite interviews, is the Council for Fiscal and Financial Policies of the ACs (also known as one of the Sectoral Conferences) that deliberates on guaranteeing equal funding, equal standards or the cohesion of the welfare state in general. Based on data on the frequency of the meetings, it is the 5th most frequently meeting Sectoral Conference, yet the interactive nature of these conferences have not had a direct impact on changing the levels of inequality, as research and my elaboration show. Nevertheless, in a country like Spain, which can generally be classified as low interactive, it still adds to the vertical and horizontal coordination mechanisms available. The politics are more judicialized in general and intergovernmental problems are resolved through the Constitutional Court. Overall, one can say that the intergovernmental negotiations are of *ad hoc* and bilateral nature in Spain. A recent development is the Guarantee of the Unity of the Markets Law in 2013, and the impact of this law on inequalities is yet to be seen. Therefore, Spain's high national income inequality levels are in consistent with the expectations of a fiscally decentralized (but still centrally managed) country with low interactive governance. Its centrifugal and less interactive governance structure, added to its asymmetric federal principles, makes Spain more prone to higher inequalities than the case of another federal country, Germany.

Looking at another federal, but interactive governance country, Germany, the overall principle of the foundation of the German federalism is more disposed to common standards of public policy rather than diversity (Jeffery 2002), compared to Spain. Germany is a federal country with regional differences and inequalities, yet there is a centralized and centralizing force to disperse the power in a regional way (Lehmbruch 1989). The existence of intergovernmental ministerial conferences is an important feature of German policy making, as well as the planning committees. Nevertheless, the federal reforms of the 2000s have had setbacks before coming to fruition. The German federal government can be considered as a coordinating actor and a central of executive coordination, which points out to another centralized feature of its governance. The Federal Chancellery can be considered as one of the manifestations of this strong central coordination (Peters 2015). The shared-rule components of regional authority are strong especially in terms of fiscal control and constitutional reform in Germany, without showing too much increase or decrease in the recent decades. Therefore, in Germany there is both self-control as well as shared control of the regions, which creates a suitable governance structure for its lower inequality levels. This structure is reflected by the existence of *Bundesrat* at the federal level, which gives the *Länder* veto power on legislation that concerns them (shared-rule), which adds to the self-rule in their regions.

Similar to Germany, Sweden is also classified as a highly interactive governance country in this work. If we operationalized interactive governance by the shared rule components of *law* *making, executive control, fiscal control, (borrowing control) and constitutional reform* of the Regional Authority Index, Sweden would not have high interactive governance. However, interactive governance is not only limited to intergovernmental affairs between different levels but also emphasizes the roles of social actors in policy-making, which is not measured by the Regional Authority Index. It is a consensus and deliberation democracy with carefully designed policies that grant local autonomy to its subnational units. Economic conditions, the regionalization process facilitated by the EU, changing coordination practices, as well as reforms on welfare state policies (such as income equalization practices, tax reforms, unemployment policies or integrative policies in health care) and the weakening of the corporatist structure might change this categorization of Sweden in the future. The possible inequality increasing impact of high *fiscal autonomy* in Sweden is offset by its high interactive governance system to a large extent – showing a conditional effect - ; and in line with the theory of this work, one can say that Sweden's inequality is still low.

Coupled with the equalizing principles of the universalist welfare system, Sweden still has high levels of redistribution, which is conducive to lower inequality. If these principles were to change, impacted by less involvement of social actors in wage bargaining, more wage differentiation or more varied fiscal and social policies, it could signal increasing inequality in the future.

Looking at the importance of social actors, the centralized wage bargaining process has been replaced with a more decentralized and industry level wage bargaining in many parts of Europe. For example in Spain, rather than wage bargaining, policy concertation has played a crucial role in the development and of the Spanish welfare system, especially with the Moncloa pacts of the democratization process, but not through established and consistent institutionalized channels that remain to this day in the same way. The centralization levels of wage bargaining have also fluctuated and the unions can be regarded as more fragmented in Spain. Again, while unions have been influential the 1980s and 1990s for the gaining of social benefits, unions did not retain a consultative role other than deliberations that were infrequent. The tripartite concertation process has been weakened over the years, despite gaining some ground in the 2000s. Looking at the quantitative indices of wage coordination (Visser 2015), one can say that the wage coordination is not as centralized as the early days of the democratization process, but also more centralized than the decentralized 1980s and 1990s.

Compared to Spain, in Sweden, this replacement has taken place in a standardized way throughout the country with the inclusion of social actors, contributing to classification of Sweden as an interactive governance country in this work. Nevertheless, the fact that wage bargaining is conducted at a more decentralized level with a less institutionalized framework in a de-corporatizing Sweden can lead to sector-wide wage discrepancies. In fact, differentiation of wages throughout the country and changes in unemployment policies are regarded as determinants of rising inequality in Sweden, along with the market forces that are in effect. Yet, attempts for strong vertical and horizontal coordination, semiautonomous agencies and its consensus based deliberative democracy show higher interactive governance, although there is no fiscal shared rule in Sweden, as stated earlier. In the case of Spain, issues that have been discussed have also changed since unions had to work on issues related to unemployment, not wage bargaining. Therefore, we need to take into account the general economic context in which these changes are occurring when assessing the role of social actors in interactive governance.

While I classify France as low interactive governance for the purposes of my typology, overall, France can be considered as a medium-low interactive governance state. Some characteristics that lead to less interactive governance in France are that there is no fiscal control of the subnational units and that there are overlapping and complex jurisdictions that make it harder to identify common goals. Unlike Sweden, it has been known more as a centrifugal and a distributive rather than a redistributive state (Peters et al. 1977). The upper chamber, the French Senate, is not considered as a chamber that creates more interactive governance, as it is known to represent rural interests more than the urban areas. Yet, the latest reforms can lead to some changes in this characteristic that has been long been accepted in France (Cole 2013). The semi-presidential France already has a unique system of coordination, which requires coordination between the president, the prime minister, the bureaucracy and the ministers (Peters 2015). While this does not necessarily mean less interactive governance, existence of its directly and indirectly elected overlapping jurisdictions adds to France's coordination and redistribution challenges.

Despite factors that lead to less interactions in governance that "matter" for inequality – such as lack of shared rule in general – and the lack of shared fiscal rule - , France's centrally designed redistributive policies have been key in maintaining a generally standardized welfare state throughout the nation. The interactive governance level of France is not low enough to offset the national equality principles, yet. More importantly, the *etatiste* nature of the system tends to prevent effective interactive governance. Less interactive governance also enables, or at least does not prevent, more regional inequality and territorial differences, which in the long run can translate to higher overall national income inequality. The insider / outsider divide that feeds from the pluralist system in France also might be a contributing factor for more inequality in the future.

Last but not least, I added the scores of each country on each feature of interactive governance that I specified in their *Interactive Governance Index* tables, adding the points from the boxes of the table. In their overall interactive governance scores, Germany and Sweden tie at **12**, France gets a score of **10**, and Spain gets a score of **8**. Are the interactive governance figures correlated with income inequality figures in line with the expectations of the theory of this work? To a large extent, they are. Sweden has traditionally had the lowest income inequality among these four countries, mainly due to its welfare state policies, but this is also bolstered by its territorial governance structure and its equalizing principles that embody its high interactive governance structure. Germany's score of 12 is also not surprising, and the central coordination principles and its general tendencies toward standardization might be preventing Germany's inequality figures from skyrocketing to the category of higher interactive governance countries, despite recent increases that thrust Germany into spotlight. One should note that Sweden is a unitary country, while Germany is a federal country, yet both of them have quite centralized redistributive systems. France's interactive governance score is in between – as a unitary state undergoing both recentralization and decentralization processes, and for the most part, the low inequality levels can be attributed to the centralized welfare state principles. Going back to the inequality trends between 2003 and 2014 again, the country with the lowest interactive governance score – 8 - is Spain, and it also experiences the highest inequality levels and also visible increases in inequality. Overall, there are significant correlations between the interactive governance levels and national inequality in these cases, in line with the expectations of this work. One question that can be raised here is whether a centralized country with low interactive governance would have more or less inequality than a decentralized country with interactive governance. While one should display caution when answering this question, without taking into account all the other variables, the cases of France and Sweden can be illustrative. As two constitutionally unitary countries, France exhibits centralized features with low interactive governance, and Sweden exhibits more decentralized features than France, with higher interactive governance. While both have lower inequality figures than the two federal countries in the typology, Sweden has lower inequality than France, overall. Again, this can be traced to the interactive governance variable, which also affects the design of welfare state policies with commitment to equality.

9.4 PUTTING ALL INTO A GENERAL FRAMEWORK: IMPLICATIONS AND FURTHER AVENUES OF RESEARCH

This dissertation contributes to the literatures of federalism/decentralization, governance and income inequality, combining a quantitative study with detailed case studies of four Western European countries. At a time when several European countries are undergoing transformations that lead to devolution, autonomy or even independence movements, such as in Spain with Catalonia, or in the United Kingdom with Scotland, the power sharing between the territorial layers, and among the actors of these layers has vital repercussions. What would happen to inequality within regions after these reorganizational processes remains as a question with highly anticipated answers. A study like this dissertation can be illuminating for such cases.

Overall, one of the major findings that should be underlined is that higher regional authority (aggregated RAI score as a whole) does not emerge as a significant predictor of inequality on its own. In any case, the results of the quantitative study show that fiscal self-rule is significantly associated with higher inequality while fiscal shared-rule is associated with lower inequality. These statistical results provide a foundation to build the more specific explanations of the cases of Spain, Germany, France and Sweden. The case studies illustrate that it is rather a) the territorial governance structure as a whole, b) the changes in it (especially fiscal decentralization, recentralization or both), and c) strongly coordinated intergovernmental relations and active social actors that complete the whole picture – with interactive governance. The findings of the case studies demonstrate that the repercussions of different types of decentralization on income inequality depend to a large extent on the kind of coordination mechanisms and the interactions in governance in a country.

More specifically, even high fiscal self-rule is not necessarily associated with more income inequality, as can be seen in the cases of Germany or Sweden. Rather, the specific mechanisms in welfare state policies that are impacted by the changes in the territorial governance patters, or decentralization or recentralization processes shed more light on the specific mechanisms. Even in systems that are decentralized, harmonization of taxes and transfers are found to be associated with lower income inequality. Furthermore, we can argue that these two cases demonstrate the mitigating effect of interactive governance on income inequality.

The findings of these case studies have important policy implications as well, especially concerning how fiscal equalization transfers are affected by the territorial governance structure. Especially the design of the financial equalization transfer systems, as demonstrated in the case of Spain, are key to ensuring regional, and overall national convergence in per capita income or per capita resources. Furthermore, fiscal shared rule is significantly and negatively associated with overall income inequality according to the quantitative study, but looking into the cases in specific also reveal different sides of this story: In the case of Sweden or Germany, there is low fiscal shared rule, but the lack of high fiscal shared rule is compensated by the other dimensions of interactive governance. Something that is not captured in the indices in Germany is that e.g. *Bundesrat* exists as a venue at a federal level that enables cooperation between territorial layers, which is preferred by the regions, rather than having more self-rule or even shared-rule at their respective regional levels. Actor preferences shape institutional outcomes, and institutional design also perpetuates preferences.

One caveat that should be kept in mind while reading this work is that income inequality by itself is a variable that is prone to measurement challenges, and that it is not a variable that often changes. Furthermore, some of the variables that are not built into quantitative indices, such as "political culture" that aims at ensuring standardization and equalization stands out as an important variable from the interviews and my research in general. The importance of the overall commitment to equality in the society, also championed by the state, can be coined as "political culture" in this case. At the same time, this variable is open to different types of operationalization in different contexts. In any case, differences in terms of political culture are especially evident in the case of Spain and Germany having different interactive governance levels and different outcomes in terms of income inequality. In the case of France, while it ranks low on interactive governance, the commitment to equality as a part of the "political culture" has been an important factor in relatively low inequality levels. The scores of the Interactive Governance Index can be used in order to integrate this variable either as a separate independent variable in a quantitative study. Even if it is not used in a quantitative model, it could be transformed to be compatible with other methodological approaches, such as a fuzzy set analysis.

Combining survey data from e.g. Eurobarometer or World Values Survey to further specify political culture can prove useful for operationalizing interactive governance. One should not lose sight of the "intension" of the variable of interactive governance, in Sartori's words, while specifying it further though. Yet, since the interactive governance variable focuses to a large extent on non-governmental actors, applying a more sociological understanding, and bringing in "network approaches" can have important contributions to the operationalization of this variable. This approach would add to a better grasp of concepts such as "coordination", power games (Scharpf 1994) or asymmetries of power between different levels and actors (Torfing et al. 2012). It would also enable us to understand what kind of policy networks exist in order to cooperate on issues related to inequality.

In the future, this project can be extended to other regions in Europe or around the world, using both quantitative and qualitative data. One suitable country for a further iteration of this project is a unitary country in Eastern Europe: Poland. As a country transitioned from communism to a democracy as of 1989/1990, it became an EU candidate, leading to membership in 2004 (Swianiewicz 2011). With the end of communism, Poland reinforced its centralization to break away with the influence of communism, but new decentralization processes ensued in the 1990s, also along with its EU accession process. At the same time, as a result of its Communist legacy, Poland had a centrally planned wage setting process, which then decentralized. It is important to analyze the Polish case especially in light of its EU accession process: Its income inequality showed an increase after the mid 1990s before stabilizing around 2005 (Brzeziński, Jancewicz, and Letki). Therefore, as a country with a democratization process much later than the countries examined in the case studies, it would especially be interesting to see whether there is a dynamic impact of decentralization and changing levels of interactive governance on income inequality, taking into account its different historical legacy, and its low levels of shared-rule in regional authority (Hooghe et al. 2016).

To conclude, one further avenue of research would be the extension of this argument to examine inequality between countries, rather than within countries. One of the reasons for the global perspective is that the world income distribution has become an important topic of debate in various fields of social science research (Wade 2017). In this perspective, the world could be regarded as one country (Milanovic 2006), and each sovereign country would then be one subnational unit – such as the regions in this work. What kind of implications would arise for global governance, based on the findings of this project? Perhaps, the most striking one is that strong evidence for interactive governance from this dissertation could be regarded as advice for more international fiscal cooperation, which does not seem to be one of the priorities in global governance, given the proliferation in regionalization. In his research, Milanovic (2016) shows that global interpersonal income or consumption distribution (Gini coefficient) has not become significantly more equal since 1980, as opposed to the arguments of neo-liberal perspectives. The ramifications of this are visible in many places in the world, with an anti global trade movement, and backlash against globalization in the US, as well as Western Europe. However, developing countries have become less unequal in this period, with a reduction of interpersonal income inequality. As there is no centralized taxing and redistributive system in the world, whether my theory travels to "the rest of the world" is debatable, but it nevertheless offers an interesting theoretical exercise. Also, at a time where the world is moving on to regionalization rather than generating multilateral regimes, and at a time where globalization is brought into question in the US, the EU and other parts of the world with protectionist tendencies, the divergence of the fiscal regimes, and the possible increase in the lack of shared rule can pave the way for more inequality among the nations of this world.

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