European Social Models and Labor Markets in the Era of Monetary Integration: From Convergence to Divergence

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Abstract
This paper analyzes the past quarter century changes in the employment relations pillar of West European social models and discusses how their interaction with the momentous changes in their economic-political context have influenced employment and inequality. Challenging the deregulatory, supply-side diagnosis prevailing at EU level, the book chapter on which the paper is based finds no trade-off between equality and jobs across countries. Job growth clearly depends on the interaction between labor demand and supply. In cases without sufficient demand, “structural reforms” brought more inequality than jobs, whereas income inequality often receded in cases with strong employment growth especially when supported by policies to upgrade skills and increase female participation. Employment performance was generally stronger outside than inside EMU, where “internal devaluation” is the main adjustment tool left, and the fallacies of financial deregulation and the EMU construction propelled divergence between core and periphery. With the crisis hitting regardless of social models, it argues that the surge in unemployment and inequality amid the euro-crisis, and the EU recipe for overcoming it by austerity and “structural reform,” raise the likelihood of deepening social cleavages within and across European countries.

1. Introduction
With emphasis on employment relations, this paper analyzes, first, the changes in European social models since the early 1990s; second, the political dynamics and economic policy frameworks that have shaped these changes; third, the relationship between inequality and job growth, and discusses, finally, the consequences of the widening labor market cleavages for Social Europe. The paper is based on a comparative chapter in a book analyzing the evolution of West European social models during the past quarter century. 1 Its central concern is how the tumultuous political and economic developments bracketed by two economic crises over this period have influenced and interacted with the social models’ evolution in shaping labour market outcomes in terms of employment and inequality. The first of the economic crises was in the early 1990s, when self-inflicted crises in the Nordic countries were followed by deep, Europe-wide recession, triggered by the end of Germany’s post-unification boom and accompanied by the near-collapse of the European Monetary System—the precursor to the Economic and Monetary Union (EMU). The second was the Great Recession, the

1 The book titled European Social Models from Crisis to Crisis: Employment and Inequality in the Era of Monetary Integration, edited by Jon Erik Dølvik and Andrew Martin, is to be published at Oxford University Press tentatively in November 2014 (http://ukcatalogue.oup.com/product/9780198717966.do). The chapter, written together with Andrew Martin, draws extensively on the book’s six case studies covering eleven West European countries – Germany, France, the UK, Italy/Spain, the Netherlands/Switzerland, and four Nordic countries – from the fall of the Berlin Wall through the Great Recession.
biggest economic crisis since the Great Depression, precipitated by the financial meltdown in 2008-09 and transformed into the sovereign debt crisis within the Eurozone, threatening EMU’s very existence and inflicting enormous social costs, especially in those member countries most involved in the debt crisis.

In both junctures policy responses were focused more on "structural reforms" in social models than on counteracting depressed demand, aggravating unemployment and straining welfare state finances. The dominant view at European level was that the job crises were mainly attributable to supply-side dysfunctions of labor market and welfare state institutions (European Commission 1993; OECD 1994). The prescription was, first, to make employment relations institutions more market-conforming by deregulation of hiring and firing and decentralization of wage-setting; second, to make the welfare state more “employment-friendly” by shifting from passive transfers to activation and strengthening work incentives by recalibrating benefits and taxes so as to "make work pay."

While the struggles over social model change in the wake of the first crisis were mainly shaped by domestic factors – variations in national institutions, the state of the labor market, and power relations in the market and state arenas – the changes during the recent crisis were to a much larger extent conditioned by pressures from financial markets and demands from supranational agencies, the EU, ECB, and the IMF (the "Troika"). Given the variations in the initial economic position of the different countries, in their social models, and in their ties to EMU, these factors led to divergent trajectories of social model and labor market change following each of the crisis junctures.

Challenging the narrow supply-side approach dominating debates about the European employment crisis, highlighting the importance of aggregate demand, and focusing on the interaction between labor demand and supply, a central message from our analyses is that labor market outcomes are decisively shaped by the interplay between economic policies and the welfare and labor regimes of the social models. Supply side changes in the social models seem to have little employment effects unless supported by growth and rising labor demand, and without such support the main result tends to be growing disparities in income and job opportunities. Conversely, in line with Kenworthy’s notion of a “high employment route to lower inequality” (Kenworthy 2008), the distributive effects of recent changes in the structure and regulation of labor markets are evidently strongly contingent on the level of growth and labor demand, as perhaps most clearly indicated by the decrease in income inequality during the pre-crisis booms in the Netherlands, Spain, and to some extent also in the UK and Germany. While we found no cross-country evidence of a trade-off between equality and jobs, increased inequalities associated with “structural reform” of the supply side in the labor market seemed rather to be a consequence of sluggish growth than a remedy to overcome it. Our findings thus suggest that the divergent labor market outcomes about which the debates over social models have been concerned have largely been shaped by the momentous developments in Europe’s system of economic-political governance – notably the flawed construction of EMU – and their fatal economic consequences rather than by the social models themselves. Due to limited space, however, the main parts of this paper will focus on the changes in the employment relations and regulation pillar of the social models, and the political dynamics and economic-political changes that have shaped them.

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2 In Germany, wage and income inequalities surged during the decade of anemic job growth up till 2005, but then flattened during the subsequent boom.
2. Changing European Social Models
The past decades’ two formative economic crises engendered quite different political responses and patterns of social model change. The changes in the 1990s and early 2000s were concentrated in three areas. First, in the labor market, employers and governments pushed for wage restraint and more flexibility in employment relations and collective bargaining. Many governments tried to lower entry barriers in the labor market by liberalizing employment protection on the margins. Second, in the welfare state realm, efforts were made in most countries to save costs and increase revenues through recalibration of benefits and stronger emphasis on activation, training, and work. Third, such efforts to boost employment were complemented by expanded education and upgrading of workforce skills. There was thus a strong rise in the supply of labor with higher education from 1990 to 2007, most pronouncedly in Spain, the UK, the Netherlands, and Norway, while it was weakest in Italy, Germany, and France. Except for a few countries – such as Finland, the Netherlands and Germany and Switzerland, which run apprentice-based systems – efforts to strengthen vocational training showed limited progress. During the euro-crisis, there were clear continuities with respect to the direction of change – emphasizing “structural reform” of labor markets and the welfare state – but the combination of financial turbulence and supranational demands gave rise in many instances to much more drastic changes than those seen in the preceding decades. This section reviews the main lines and variations of change in employment relations and regulations over the past decades.

Partial Liberalization of Labor Market Regulation
In employment relations and labor market regulation, two main trends could be identified prior to the Great Recession: first, a tendency toward partial deregulation of employment protection, mainly in temporary work; and second, a continuation of past tendencies of union decline and decentralization of collective bargaining, accompanied by a general shift to wage moderation in the context of monetary integration. The latter trend persisted during the crisis, and was in several instances reinforced by intervention in wage setting by the Troika, whereas the previous trend toward liberalization of temporary work was superseded by efforts to ease dismissal protection for permanent workers, especially in the debt-ridden countries (OECD 2013c: 67). Especially after the 2004 EU enlargement, increased cross-border labor mobility and low wage competition added to the strains on employment relations, prompting regulative initiatives to shore up national wage floors (Dølvik, Eldring and Visser 2014).

The tendency toward deregulation of temporary work—covering fixed-term contracts and agency work—was especially pronounced in the 1990s (Figure 1). The most significant liberalizations occurred in Italy, Germany, and Sweden, but the Netherlands, Spain, and Denmark (regarding agency work), and, somewhat earlier, Finland, also went along this path. In the liberal UK and Swiss labor

3 In many countries, the emphasis on activation was considered complementary to partial deregulation aimed at making labor markets more accessible. Several governments also offered employers reduced social security contributions for special categories of workers or jobs – such as the ‘mini’ and ‘midi’ jobs in Germany, and new entry jobs in other countries – while workers accepting low-wage jobs were granted various kinds of tax deductions, earned income-tax credits, and other in-work-benefits. Combined with deregulation of parts of the labor market where most participants were likely to be activated – in the 2000s framed by the notion of “flexicurity” – these changes entailed a dual movement whereby re-commodification was associated with a stronger state hand in restructuring the labor market, especially its periphery.
markets there was little change. At the other end, regulation of fixed-term work was tightened in France and Norway. During the crisis there was little change in temporary work regulation, while

Figure 1 Strictness of employment protection regulation regarding dismissals (collective and individual) and temporary work (incl. temporary agency work ) 1990, 2000, 2008, and 2013.*

*Revised OECD Employment Protection Indicators, 2013, including also rules laid down in collective agreements and court practice. As the revised dismissal indicator is only available from 1998, the first observation here refers to 2000. (www.oecd.org/employment/protection).

implementation of an EU Directive on Temporary Work Agencies entitled agency workers to equal treatment with user firm employees, although it left plenty of scope for evasion. As there was almost no change regarding dismissal protection for the permanently employed in the decades preceding the crisis, the moves toward “flexicurity” tended to involve increased flexibility for those in the periphery of the labor market, while those in the core retained security. Eventually reinforced by increased labor migration, this led to a rise in temporary work and labor market dualization, the detrimental effects of which during the crisis eventually spurred a shift toward easing of dismissal protection for permanent workers in more than one-third of OECD countries (OECD 2013c: 93).

In the EU this tendency was especially pronounced in the debt-ridden euro-countries subject to the conditions set by the Troika for granting financial support (Clauwaert and Schönemann 2012; OECD 2013c: 93). Among our case countries, Spain enacted a series of legislative changes which significantly eased individual dismissals; the notice period was halved, compensation for unfair dismissals was reduced, and procedures for collective redundancies were simplified by establishing “objective” economic criteria, reducing severance pay, and easing administrative proceedings. Changes in Italy were more modest, mainly restricting possibilities for reinstating unfairly dismissed workers to the more severe cases of discrimination.4 In 2013, the UK, France, and the Netherlands also eased dismissal regulations for permanent employees, alongside some tightening of rules for

4 S. Pérez & M. Rhodes, “The Evolution and Crises of the Social Models in Italy and Spain”, in Dølvik/Martin 2014.
temporary work. As these changes (except for in the UK) pertained to cases with strong insider protection and quite dualized labor markets, they implied a certain convergence between Continental and Nordic countries, where dismissals for economic reasons have always been quite liberal.

**Changing systems of employment relations**

As regards employment relations, one must distinguish between the impact of longer-term structural and institutional change observed during the pre-crisis period and the divergent consequences of, and responses to, the crisis. The pre-crisis period was associated with continued union decline in all the case countries. The most dramatic drop was in Germany, where the unions lost more than one-third of their membership from 1992 to 2008, and the density rate dived from 34 to 19 percent (See Table 1 below). In Denmark and Sweden the decline in density among blue-collar workers accelerated sharply in the 2000s, when Center-right governments raised union fees by reducing tax deductions and undermined the solidarity principles underlying the Ghent system of unemployment insurance. The decline in union membership continued in most countries during the crisis, but as unemployment disproportionately hit groups with low propensity to organize, union density tended to flatten (AIAS 2013).

In most of the case countries the impact of union decline on collective agreement coverage was limited due to statutory mechanisms for extension of agreements (erga omnes), which normally also bolsters the organization rate among employers (Traxler et al. 2001). In the Nordic countries—where only Finland extends agreements on a regular basis—stable organization rates on the employer side kept up coverage. The main exceptions were Germany and the UK, where coverage fell strongly for the period 1992–2008. During the crisis, there was a major drop in coverage in Spain, while the decline accelerated in Germany and the UK. In the other countries there was registered little change. Already prior to the crisis, however, the increased hiring of labor migrants and workers from the new Member States posted by foreign subcontractors was often associated with inferior conditions and circumvention of agreements (Dølvik and Visser 2009). In response, many countries changed their laws so as to enable extension in more sectors – among them the Netherlands, Switzerland, France, and, earlier, Norway – eventually followed by Germany which decided also to establish a statutory minimum wage by 2015 (Dølvik, Eldring and Visser 2014). Yet, the efforts to curb wage dumping from foreign sub-contractors were in 2007-8 constrained by landmark decisions of the CJEU – the so-called “Laval Quartet” – which not only prohibited host country requirements beyond minimum pay set by

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5 In France, a labor code change allowed the social partners in companies in serious difficulties to negotiate firm-level agreements on temporary wage and working-time reductions in exchange for a job guarantee (OECD 2013c: 95). Workers rejecting such options can be fairly dismissed and collective dismissals procedures were simplified. A new “non-conversion tax” imposes higher social security contributions on companies where a fixed-term contract is not eventually transformed into an open-ended one. In the UK, the notice period in the case of mass redundancies was reduced (from 90 to 45 days), and protection of fixed-term contracts somewhat tightened. In the Netherlands, a tripartite agreement in 2013 strengthened protection for fixed-term workers, simplified procedures for collective and individual dismissals, and lowered the cap on severance pay for individual dismissals.

6 As a result of increased use of low-paid migrant labor after the fall of the Berlin Wall, the EU adopted in 1996 a directive that should secure workers posted by foreign companies equal treatment with host country workers as regards core labor standards, including minimum wages defined in law or extended agreements (EC 96/71). Except Sweden and Denmark, most countries relied on varying extension mechanisms, whereas in 1997 the UK established a (low) national minimum wage.
statute, or extension, and a nucleus of labor standards, but also outlawed union action aimed to secure posted workers terms beyond those legal minima (Evju and Novitz 2014). By widening the scope for cross-border low-wage competition, this added to the pressures on employment relations and working conditions in the wake of the euro crisis.

Table 1. Trade union density, collective bargaining coverage, extension, and minimum wage

<table>
<thead>
<tr>
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<th>Union density</th>
<th>Bargaining coverage</th>
<th>Extension</th>
<th>Minimum wage</th>
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<tbody>
<tr>
<td>Finland</td>
<td>78</td>
<td>67</td>
<td>69</td>
<td>82</td>
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<tr>
<td>Sweden</td>
<td>85</td>
<td>68</td>
<td>68,9</td>
<td>89</td>
</tr>
<tr>
<td>Denmark</td>
<td>76</td>
<td>68</td>
<td>68,5</td>
<td>84</td>
</tr>
<tr>
<td>Norway</td>
<td>58</td>
<td>53,3</td>
<td>54,6</td>
<td>72</td>
</tr>
<tr>
<td>UK</td>
<td>38</td>
<td>27</td>
<td>25,8</td>
<td>40</td>
</tr>
<tr>
<td>Germany</td>
<td>34</td>
<td>19</td>
<td>18</td>
<td>70</td>
</tr>
<tr>
<td>Switzerland</td>
<td>23</td>
<td>18</td>
<td>17,2</td>
<td>48</td>
</tr>
<tr>
<td>Netherlands</td>
<td>25</td>
<td>19</td>
<td>19</td>
<td>82</td>
</tr>
<tr>
<td>France</td>
<td>10</td>
<td>8</td>
<td>7,9</td>
<td>92</td>
</tr>
<tr>
<td>Italy</td>
<td>39</td>
<td>33</td>
<td>35,2</td>
<td>83</td>
</tr>
<tr>
<td>Spain</td>
<td>17</td>
<td>15</td>
<td>15,6</td>
<td>82</td>
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* Finland 2009, **Germany will enact a national minimum wage by 2015. Source: AIAS, ICTWSS database 2013.

Pre-crisis trends in Collective Bargaining

Although the dominant levels of national collective bargaining remained fairly stable prior to the crisis—varying between industrial bargaining and peak-level concertation—there was significant decentralization of the actual determination of wages and working time to the company level in most countries. In many instances these processes took the form of organized decentralization—typically in the Netherlands, Sweden, and Denmark—and in sectors with strong bargaining partners, typically manufacturing—but more disorganized patterns of decentralization were spreading, not least in the private services sectors (Traxler et al. 2008; Marginson 2014). A trend-setting example was in German manufacturing, where company-driven introduction of “opening” or “hardship” clauses in central agreements – alongside increased outsourcing – unleashed a wave of concession bargaining and hollowing out of the agreements at the company level. Under the euro-crisis such “opening clauses” became standard ware in the Troika tool-kit of “structural reform” (Schulten and Müller 2013).

Paralleling decentralization, the 1990s brought a wave of social pacts and other forms of peak-level concertation (Hassel 2006; Dølvik 2004). In many instances, the revival of tripartite exchange was linked with efforts to develop more articulated forms of multilevel bargaining (Marginson and Sisson 2004) and compensate for institutional weaknesses in countries lacking the traditional prerequisites.

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7 The prohibition of such union action was in 2013 deemed in breach of ILO convention 87 by the ILO Committee on Freedom of Association and also declared in contravention of the European Charter of Human Rights.

8 In Denmark and Sweden this formed part of a broader shift towards sector-based pattern-bargaining (Andersen et al. 2014).
associated with neo-corporatism, typically Spain and Italy (Regini 1997). As in the Netherlands, Finland, and Norway as well, social pacts were commonly triggered by critical junctures—economic crisis or efforts to fulfill the EMU entrance criteria—and were aimed to promote wage moderation by improving the social actors’ coordination capacity and strengthening their co-responsibility for reforms in labor market and social policies, thereby also bolstering state capacity. In contrast to the other countries in the study, none of the large countries—Germany, France, and the UK—were able to develop tripartite exchange. During the euro-crisis, concertation was revived in Italy, but was largely replaced by unilateral government intervention in Spain, whereas other instances of tripartite exchange, such as in the Netherlands, Finland, and Germany, were mainly limited to specific issues.

The move toward low-inflation policies and monetary integration in the 1990s generated strong pressures for wage coordination and moderation. During the EMU convergence programs of 1993–98, nominal wage increases fell from 7.5 to 1.5 percent in the euro-area (Janssen and Mermet 2003: 673). With no monetary policy tools left at the national level, and fiscal policy constrained by the EMU public deficit and debt criteria, it was clear that the evolving EMU regime would require increased aggregate wage flexibility at national levels (Traxler 1996; Pochet 1999). While the ECB and European employers’ associations called for more decentralized wage setting adjusted to company variations in productivity, most governments and trade unions tried to bolster competitiveness by strengthening national coordination. Fearing that EMU would unleash a deflationary dynamic of downward wage competition and “beggar thy neighbor” policies (Dølvik 1998, 2004), the European Trade Union Confederation (ETUC) called for a fiscal counterpart to the ECB and for EU-level coordination of macroeconomic policies and wage policies to ensure sufficient demand (Foden 1996; Janssen and Mermet 2003). While it soon became clear that the macroeconomic dialogue between the ECB, the Commission, and the social partners established in 1999 was a purely symbolic exercise, the unions tried to coordinate wage setting on the basis of the “inflation plus productivity growth” formula developed by the European Metalworkers’ Federation (Schulten 2001). However, the supposed pace-setting unions in Germany proved unable to fill their role, as reflected in the fall in German real wages and unit costs from the mid-1990s. As this restrained wage setting in surrounding countries (Traxler and Brandl 2009), it contributed to the decline in the labor share of value added in the Eurozone core countries, adding to the effects on labor demand of the restrictive macroeconomic policies imposed by the ECB and EMU rules (OECD 2012a; Glyn 2006: 190–92).

In several countries in the Eurozone periphery, however, the construction flaws of the EMU – i.e. the lack of supranational regulation and supervision of financial markets, and the lack of fiscal stabilization mechanisms (Martin 2014) – resulted in credit-driven economic overheating which spilled over to wage setting in the 2000s.9 In Italy and Spain, however, annual real wage growth 2000–07 was actually lower than in Germany and EU-15, suggesting that the rise in aggregate unit labor costs in Spain had to do with the strong expansion of low productivity jobs in the non-tradable sectors.10 Nonetheless, when the sovereign debt crisis brought the core-periphery disparities in imports and exports to the fore, the ensuing policy responses also propelled stark divergence in the development of national labor market institutions.

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10 Annual real wage growth 2000–07 was 0.1 percent in Spain, 0.8 percent in Italy, 0.9 percent in Germany, and 1.1 percent in EU-15. Labor compensation shares of GDP remained stable in Spain and fell in Italy (Pérez and Rhodes 2014).
Crisis adjustments in collective bargaining systems

In the countries drawn into the sovereign debt crisis, the actors and institutions faced tremendous strains, while the initial effects in the countries that escaped the storm were much less consequential (Marginson 2014). In the latter, the actors mainly responded by invoking traditional institutional tools, alongside a range of incremental and sometimes innovative adjustments undertaken to cope with the initial shocks. Although peak-level crisis-settlements were rare and retrenchment in pensions and social services often sparked union protest and demonstrations, there was some revival of tripartite concertation. Wage moderation was mostly agreed through normal bargaining procedures, often accompanied by clauses allowing exemption from central increments in hard-hit companies. Locally negotiated “emergency pacts” flourished in manufacturing and construction in many countries (Zagelmeyer 2011; Lehndorff 2011; OECD 2010: 19), often associated with burden-sharing through increased working-hours flexibility and rotating lay-offs agreed in local negotiations required to utilize state-subsidized schemes for short-time work (STW) (Glassner et al. 2011).

In Germany, the government and the social partners agreed on improved terms and extended application of such STW-schemes, and amendments in the same vein were made in other countries. In the Netherlands, central deals were struck on wage moderation, but also on adjustments in unemployment benefits and dismissal protection. In proto-corporatist Finland, the employers called for decentralization of bargaining, but eventually had to go along with tripartite incomes policy agreements. In France, the social partners made deals with the state regarding flexible youth contracts and labor code changes that allowed agreements on reduced working hours and pay in exchange for job guarantees, whereas unions were divided about successive adjustments in pension systems. In Sweden, the lack of a public STW-scheme prompted negotiation of a “crisis agreement” in manufacturing in 2009, where IF Metall acceded to key workplace unit demands to allow local agreements on cuts in working time and pay of up to 20 percent to retain labor and share the burden of job and pay losses in the workforce (Svalund et al. 2013). In the Swedish context such a deal was path-breaking, and was in 2012 followed up by a broader agreement prodding the government to create a state-funded STW-scheme from 2014. The unions also got the Center-right government to reverse the controversial differentiation of contributions to unemployment funds which had prompted huge membership losses in the funds and the unions alike. In Denmark, however, the Red-Green government’s call for a tripartite “crisis settlement” on longer working hours in 2012 was resolutely rejected by the manufacturing unions.

In the countries hit by the sovereign debt crisis, by contrast, the Troika required sweeping changes in collective bargaining institutions, emphasizing decentralization; introduction of “opening clauses” at the company level; de-indexation; more flexible, productivity-based wage setting; and cuts in minimum wages and public sector pay (Degryse et al. 2013). In the ECB and the evolving EU economic governance machinery, the institutions of wage setting became central targets in the agenda for “structural reform,” featuring high in many country-specific recommendations adopted by the Council (Schulten and Müller 2013). In Spain, concertation largely broke down, and the government enacted legislative changes allowing firms to unilaterally change pay and working conditions whenever there are objective economic, technical, production, or organizational reasons (Meardi 2012; OECD 2013c: 12). Firms are also allowed to strike agreements with workers—local unions or even unorganized workers—on terms below those set in sector bargains. Shortening of the termination time for agreements that are not re-negotiated within one year has also eased employer exit from bargaining. Without mooring in a collective agreement, and with low density and patchy
industrial relations, the regulative changes in Spain are thus likely to have much greater impact than in Italy, where the conditions for derogations from sector agreements were determined through bi- and tripartite concertation.\textsuperscript{11} A controversial tripartite deal in 2009 signed by only two of the three Italian union confederations was in October 2011 superseded by a bipartite agreement between Confindustria and all three union confederations, allowing local derogations and committing to plant-level bargaining in future agreements, ruling out their use in lowering standards. This pre-empted a former decree by the Berlusconi government, allowing local derogations both from labor law and agreements.\textsuperscript{12} The Italian unions’ consent to bargaining reform could also be seen as quid pro quo for a sequence of tri- and bipartite deals transforming the Cassa Integrazione Guadagni (CIG) into a “social shock absorber” (short-term work-scheme), which were eventually complemented by negotiated reform of the unemployment benefit system, reducing the number of uncovered workers from 2 million to approximately 600,000 (ibid.; Sacchi 2013).

Regardless of the divergent economic and institutional impact of the euro-crisis, collective bargaining, and unions in particular, have come under increasing strain in all our case countries. In the hardest-hit countries, this unleashed waves of social unrest, work stoppages, and numerous general strikes as in Spain. While the decline in unionization and bargaining coverage accelerated in Germany, the UK, and Spain in particular, increased unemployment and low-wage competition alongside reduced reservation wages have weakened the bargaining power of workers in most countries, tempting more companies to operate outside the jurisdictions of collective agreements. Although the employment relations institutions are evidently more resilient in some countries than others, the crisis and the EU political responses to it seem to imply a new twist in the long-term weakening and fragmentation of the employment relations pillar of the social models observed in the preceding decades (Puligniani and Arrowsmith 2013; Marginson 2014).

Towards “a new EU interventionism” in collective bargaining?

Such dynamics have clearly been amplified by the political pressures from EU/EMU-institutions to undertake “structural reforms” in the bargaining systems (Schulten & Müller 2013). In line with the EU/ECB diagnosis of the malaise as primarily a debt and competitiveness crisis, a widely quoted “main conclusion” of an ECB report on “Euro area labour markets and the crisis” was that “downward wage rigidities are an impediment to restoring competitiveness (and thus employment), particularly in those euro-area countries that had accumulated external imbalances before the crisis” (ECB 2012: 9). In the same vein, a Commission DG ECFIN report suggesting a range of “employment friendly reforms” comprised a sub-section on “wage bargaining framework” that pointed to decreases in statutory and contractual minimum wages, bargaining coverage, and extension of collective agreements, which alongside other measures would “result in an overall reduction in the wage setting power of trade unions” (Erne 2012; European Commission 2012a: 103–4).

A range of Member States have thus received recommendations to adjust wage setting systems, such as calls for decentralization (Italy), or more moderate increases of wages in general (Italy, Finland) or of minimum wages (France), while Sweden was urged to address high wages at the lower end of the

\textsuperscript{11} Pérez and Rhodes, 2014.

\textsuperscript{12} FIAT, which had tried to obtain a deal with the unions along the lines of the Berlusconi Decree, subsequently left Confindustria to pursue its own plant-level goals.
wage scale. However, wage increases more in line with productivity were suggested in the case of Germany, which might be viewed as a plea for somewhat higher wage growth. The most direct impact of what Schulten and Müller (2013) have coined as the “new European interventionism” in national wage setting was seen in the countries under economic surveillance by the Troika, where the measures referred to above were often coupled with unilaterally enacted pay cuts and freezes in the public sector, contributing to a decline of more than 6 percent in real wages in Spain and 3 percent in Italy 2010–12.

While these developments have been interpreted as a “paradigm shift” in the EU approach to national wage setting (Schulten and Müller 2013) —hollowing out coordination and multi-employer bargaining (Marginson 2014) —Visser (2013: 2) notes in a report to the Commission DG ECFIN that this is precisely the same approach as the OECD recommended in its 1994 Jobs Strategy, but later had to revise in its evaluation of the strategy (OECD 2006) as it turned out that “under conditions of efficient coordination inclusive bargaining models [...] can perform as good as the exclusive, decentralized systems it had initially recommended” (ibid). Noting also that the new economic governance system of the EU is favoring company bargaining and limiting coverage and multi-employer bargaining, he further states that “[t]his is the exact opposite of the lesson of the 1930s and it is remarkable to a social scientist how such recommendations can be made on the basis of what appears to be very limited econometric evidence and generally poor understanding and measurement of institutions” (Visser 2013: 2).

2. Political Dynamics and Economic Frameworks of Social Model Change

The changes in the social models initiated in the wake of the German reunification crisis and those undertaken during the euro-crisis were shaped by very different political dynamics and economic conditions. In the latter instance, the political processes in several case countries were heavily influenced by the collapse of the financial markets, their reactions to the ensuing sovereign debt crisis, and the increasing role of EU/ECB in determining the conditions for national responses— reducing the scope for political-democratic deliberation and adjustment in accordance with national legacies. Also in the 1990s, the countries faced significant external pressures—eventually related to the processes of market and monetary integration—but the actual course of change took diverse national routes. The fact that politicians and social actors were situated in distinct national realities, institutionally and economically, conditioned their perceptions of interests and feasible problem-solving as well as the distribution of power resources to pursue them. The case studies point to this in several ways. First, they show that the dynamics and stability of political coalition-building were critical for the ability to reach decisions regarding social model change, varying significantly among countries. Second, besides differences in institutional frameworks, the actual struggles over policy choices were conditioned by the actual state of the labor market and public finances. Third, the power relations among the actors engaged in the politics of social model change—in the market as well as state arenas—were crucial in shaping the trajectories of change. Such factors also influenced developments during the euro-crisis, but especially in the hard-hit countries in the Eurozone the

13 De facto implying a demand for extension of the low wage sector, this prompted protest from the Swedish unions and the point was erased in the final Council version.
constraints imposed by financial market reactions and the tightened EU regime of economic governance radically altered the political frameworks for adjustment.

The ability to form political coalitions capable of conducting change varies partly with political institutions. In countries with proportional representation electoral systems, prior to the crisis the occurrence of viable change coalitions seemed contingent on the presence of either a predominant Christian-Democratic or Social Democratic “catch-all” party able to coalesce to the right or left respectively (see Iversen and Soskice, Chapter 9 of this volume), and to get unions on board where their support was necessary. This was the case in the Netherlands and the Nordic countries, but proved more demanding during the recent debt crisis in the Netherlands and Denmark. Even where such parties exist, however, bicameralism built on federalism can result in “joint-decision traps” that block change (Scharpf 1988, 1994), as it did in Germany where it took a de facto Grand Coalition between internally divided catch-all parties to break a prolonged stalemate in the early 2000s and implement the contested overhaul of the German social model (the so-called Hartz reforms).

Formation of a new Grand Coalition in fall 2013 resolved a long-standing deadlock over establishment of a statutory minimum wage. In the UK, the majoritarian winner-take-all system for determining control of a unicameral legislature in a unitary state enabled the Conservatives under Thatcher, New Labour under Blair, and eventually the current Coalition under Cameron, to carry out their respective change agendas much more easily. In principle, this was also the case in France’s presidential system, but the coalitional complexities of legislative majorities and the frequent eruptions of extra-parliamentarian protests limited the room for maneuver. The institutionalization of strong regionalism in Spain was a constraint that could occasionally be circumvented insofar as support for reforms could be mobilized through social pacts. This was only temporarily the case in Italy, where opportunities for social model change were opened up and closed off by the changing configuration of the party system.

Critical Junctures As Catalysts for Change: The Five Large EU Countries

Even prior to the Great Recession, major social model changes were in most cases precipitated by economic crises or critical junctures in national development—in some instances accentuated by the need to adhere to supranational EMU rules—but the course of change was mainly shaped by the dynamics of national politics. However, the political leeway and available tools for adjustment varied significantly depending on relationships with the EMU, as demonstrated by the diverse trajectories of change in the five largest EU countries.

Germany’s reunification was the most far-reaching of such national precipitants of social model change among our cases.14 There, unsurprisingly, the widely supported initial responses to problems resulting from reunification relied on the institutions and instruments at hand in the existing West German social model. While rapid extension of the West German currency at a 1:1 rate, wage rates, and social model institutions generally to the ex-GDR hastened the eastern labor market’s collapse, the tools available in the Bismarckian welfare state were used to cope with its social consequences. But the fiscal costs of doing so could not be managed in the context of low growth maintained by the Bundesbank’s highly restrictive monetary policy in response to the initial post-unification boom and

the taboo on expansionary demand-side policy. Meanwhile, large firm managers responded to competitive pressures and opportunities, produced in part by the opening to the east, by using the mechanisms of Germany’s employment relations system to bring about substantial changes in the labor market. Through local concession bargaining with works councils and “opening clauses” in sectoral agreements, the hallmark institutions of coordinated wage setting were hollowed out, facilitating a sweeping restructuring which preserved the job security of the core skilled labor force while shifting functions to a growing segment of less protected, sub-contracted labor (see also Streeck 2009). A novelty in company employment relations that eventually became important under the financial crisis was the creation of time accounts that enable greater working time flexibility (Lehndorff et al. 2009). The associated shift of power resources in favor of managers in the labor market and toward the more business-oriented factions in the SPD paved the way for ending the stalemate over coping with the accumulated fiscal squeeze and the violation of the EU Stability and Growth Pact budget rules (that Germany had insisted on), intensified by renewed recession. Absent demand-side options and burdened by the highest real interest rates in the Eurozone—determined by low inflation and the one-size-fits-all rate of the ECB—the German policy-makers saw no other option than resorting to supply-side strategies (Scharpf 2012: 117). With CDU–CSU support in the upper house, the SPD–Greens coalition did so by largely supplanting the Bismarckian system of unemployment and pension benefits, expanding the non-standard, low-wage labor market, and reducing taxes on company profits and capital incomes (ibid.: 120). After a period of a CDU–SPD Grand Coalition led by Merkel presiding over the recovery prior to the crisis, the CDU governed in coalition with FDP during the first five years of the Euro-crisis. In the initial phase of the crisis Merkel revived past traditions of social partnership to revamp the Kurzarbeit schemes. Eventually supported by strong economic performance, she also backtracked on the previous agenda of social policy change and actually expanded public expenditure. Still, bargaining coverage and unionism continued to decline. When a new Grand Coalition led by Merkel was formed in fall 2013, besides further change in the pension system, it was also agreed to establish from 2015 a statutory minimum hourly wage of €8.30, which in accordance with union demands was a condition for SPD entering a new Grand Coalition with the CDU.

In Italy, the first critical juncture originated with the breakdown of the postwar party system in the early 1990s that brought the technocratic Dini government into office at the same time as meeting the Maastricht convergence criteria so as to qualify for EMU was perceived as an imperative. Alongside a substantial depreciation of the lira amid the ERM crisis, this combination of factors induced the otherwise divided social partners to strike a compromise to end wage indexation (scala mobile) and negotiate reforms in the antiquated pension system favoring unionized insiders. Political division and instability soon brought the reform process to a halt, however, and the spell of coordinated reform efforts among the social partners dissipated once the hurdle of EMU membership had been overcome and a divided Center-left was replaced by a Center-right coalition headed by the notorious Berlusconi. Hence, in the decade preceding the financial crisis very little was accomplished in terms of overcoming the dualization of the Italian labor market, the gap between North and South, the financial burden of the insider-oriented welfare system, and the huge public debt which to a large extent was held by Italian citizens. When the contagion in the financial markets pulled Italy into the sovereign debt crisis and the country became subject to the EU/ECB regime of

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15 Pérez and Rhodes 2014.
crisis management, the political processes fundamentally changed. Eventually Berlusconi had to resign after heavy pressure from the EU; the technocratic Monti government came into office, and, in the context of falling GDP and surging unemployment, adopted a range of saving packages, raised the retirement age, and launched social reforms required by the EU/ECB. However, the still-strong social partners invoked past practices of bilateral and trilateral crisis cooperation aimed to influence the process of change, leading (amongst others) to broadened schemes for short-term work (Cassa Integrazione, CIG), negotiated terms for decentralized bargaining, and extension of the patchy Italian system of unemployment compensation. When a broad coalition government took over after the 2013 election, Italy seemed to have entered a calmer phase, as in the mid-1990s, but the sluggish economy, high debt and unemployment, and the tightened conditions of the renewed EMU governance system indicated further uphill struggles and political volatility, as illustrated by a new shift of government in 2014.

In France, where no comparable instance of crisis occurred, the pressures for social model change were less acute in both phases. Given the absence of any tradition of social pacts, and the political mobilization capacity of the divided, competing trade unions—in 1995 forcing out the Juppé government after its efforts to reform the pension system—successive governments under different partisan control limited themselves to cautious and incremental adjustments in social policy. These were frequently driven by ad hoc efforts to meet the EU deficit requirements. Since the restrictive monetary policies of the ECB and stagnant German demand engendered low French growth, while alternative increases in revenues were blocked by election pledges to bring down taxes, no real attempts were made to address the growth of public debt. During the euro-crisis, France steered a difficult course between the hard-hit Southern countries and the better-faring Northern countries. With strained public finances and rising unemployment, the Conservative government of Sarkozy was in 2012 replaced by the Left government of Hollande. However, squeezed between the sluggish economy and EU/ECB demands for austerity, Hollande’s calls for more growth-friendly EU policies came to naught and both governments went ahead with contested, incremental changes in the pension system and eventually employment protection—as usual in France, sparking union protest. Yet, the French governments refused to heed the EU/ECB calls for massive spending cuts and sought to stabilize public finances by increasing taxes. After initially reversing Sarkozy’s rise in retirement age, Hollande eventually also gained support for adjustments in the pension system and employment protection from a majority of the main unions and employer confederations. However, the economic arm of the Commission continued to criticize France for not enacting tax reliefs and more “structural reforms,” which in its view was the only way to boost a dynamic recovery (Rehn, European Observer, November 2013). Early 2014, Hollande thus launched a “responsibility pact” by which employers were promised substantial tax reliefs if they increased employment.

In Spain, EU membership and adjustment to the single market under the Gonzales Socialist government spurred an early wave of government–union pacts aimed at modernizing the welfare state. But this wave subsided as tensions between Gonzales and the unions built in the context of rising unemployment after Spain tightened monetary policy in order to stay in the ERM during its early 1990s crisis. Under the Aznar Conservative government there was a second wave of pacts—

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16 J. le Cacheux & G. Ross, ‘France in the Middle’ in Dølvik/Martin 2014.

17 S. Pérez & M. Rhodes 2014.
mainly aimed at reforming the collective bargaining and employment protection systems in the
dualized Spanish labor market in the course of adjustment to EMU. After the peseta was locked to
the euro in 1999 (at terms implying an effective depreciation of the exchange rate), increased
inflation and low real interest rates gave impetus to strong growth in GDP, employment, and public
revenues in Spain in the 2000s. The boom was further fueled by surging credit-driven investments in
the construction and tourist sectors and by labor immigration. While the 15 years of solid growth
enabled the shifting minority governments to modernize the systems of welfare and education and
maintain healthy public finances, their limited powers—reliant on support from regional parties—
and the fragmented employer-side in particular, meant that not much was achieved to overcome the
mounting structural problems of the dualized Spanish labor market and economy. As the Spanish
construction boom came to a halt and unemployment started rising in 2007, the Spanish banking
system was already in difficulties when the financial crisis hit in 2008. With initially solid budget
surpluses and low state debt, the Socialist government of Zapatero tried to halt the downturn with
expansionary policies at the same time as it had to rescue failing banks. However, surging
unemployment, falling revenues, and fast-growing expenditures resulted in fast-widening gaps in
public budgets and rising debt. Although Spain still had a lower public debt ratio than Germany, the
herd reactions of the financial markets after the Greek collapse—many-doubling interest on Spanish
bonds—pushed Spain into the center of the financial storm in 2010. Under pressure from the
EU/ECB, the Zapatero government launched a series of saving packages, raised the retirement age,
and invited the social partners to talks on labor market reforms, but in the context of mounting
popular protest, youth indignation movements, and several general strikes, such talks soon
dissipated. As the storm intensified and the EU/ECB demanded ever more forceful measures of
austerity and “structural reform,” the Conservative government of Rajoy elected in fall 2011
desperately slashed public budgets, welfare, wages, and pensions, alongside sweeping measures to
deregulate employment protection and collective bargaining. Although ECB President Draghi’s 2012
pledge to buy as much debt as required to calm the markets brought down interest on Spanish
bonds, the second dip in the Eurozone recession reinforced the contraction of the Spanish economy,
and the rise in public debt, unemployment, and emigration of educated young people continued.
Compared to Italy, the prospects for stabilization of the political and social situation, and the
relations between the social partners, looked grimmer in Spain due to deepened divisions and loud
calls for autonomy among the regional governments.

In the UK, the economic policy crisis that forced sterling out of the ERM in 1993 permitted a
depreciation that opened the way for steady growth. This enabled the New Labour government that
entered office in 1997 to make modest changes in the social model, leaving largely intact the more
substantial changes made to it under Thatcher’s Conservative government. Apart from introducing
a low statutory minimum wage, its main concern was to improve education and health services and
increase transfers to families with children at risk of poverty. In the context of steady employment
growth these measures halted the rise in income inequality. However, given the majoritarian
parliamentary system and New Labour’s targeting of the median voter by pledging to keep taxes low,
this eventually implied increased reliance on borrowing in the 2000s. In combination with the
government’s “light touch” on the financial sector and its neglect of the mortgage boom, the
consequence was the asset-driven pumping up of a financial bubble. Thus, the UK entered the

18 K. Mayhew & M. Wickham-Jones, ‘The United Kingdom’s Social Model: From Labour’s New Deal to the
Economic Crisis and the Coalition’, in Dølvik/Martin eds. 2014.
financial crisis with huge private debt and higher state debt than most of the Eurozone countries. As the Treasury tried to rescue the City from collapse and counter the downturn with expansionary fiscal policies, state deficits and debts surged rapidly from 2008, making the New Labour government of Brown an easy prey for the opposition headed by Cameron in the 2010 election. Although interest rates on British bonds remained low and the UK, with its own currency and monetary policies, had no difficulties servicing its state debt, the Coalition government initiated a harsh austerity program with deep cuts in social spending, increased tuition in education, and higher direct and indirect taxes (VAT), the regressive effects of which were partly compensated by increased transfers to low-income families with children. Still, the National Health Service and the basic traits of the social model inherited from Thatcher and Blair were not fundamentally challenged.

The Politics of Social Model Change in the Smaller States

Social model change was also triggered by critical junctures in the smaller and more peripheral EU/EEA countries, but the conditions for handling them varied from the larger countries, especially inside the Eurozone.

In the Netherlands, the era of social model reform, wage moderation, and stability-oriented economic policies was initiated by the Wassenar Accord brokered by Conservative Prime Minister Lubbers in direct response to the “Dutch disease” in the 1980s. With employers coordinated at the peak level and the trade unions as junior partners, it proved possible to accomplish the “Dutch Miracle” and qualify for EMU through a series of social pacts regarding welfare state and labor market reform under the “Purple” coalition government in the 1990s (Visser and Hemerijck 1997). Supported by coordinated wage restraint “in the shadow of hierarchy,” strict activation requirements, transfer of costs for sick leave and disability pensions to the employers, and “flexicurity” reforms in the labor market, the rising employment and falling income inequality distinguishing the Dutch case illustrated that “internal devaluations” could in fact work in small, export-oriented Eurozone economies.

Contrary to the notion that macro-corporatism was reliant on predominant Social Democratic parties and strong trade unions, the Netherlands and Switzerland represent cases where concerted social change was shaped by coalitions in which Center-right parties and employers played leading roles. A case in point in Switzerland was the broadened extension of collective agreements in the 2000s, which was a union precondition for supporting opening of the labor market to the new EU Member States. In the Netherlands the “polder model” was embraced by all mainstream parties, but in the early 2000s the central bank and the shifting coalition governments—under growing influence from liberal and welfare-chauvinist parties—were unable to check the rise in asset-based borrowing, pumping up a private debt bubble. Switzerland saw no such bubble and fared better than most other countries during the euro-crisis, partly because the surge in labor immigration from the enlarged EU boosted domestic demand. The Netherlands also seemed to ride out the financial crisis smoothly, but from 2012 the combination of private deleveraging and austerity policies brought decreasing demand and employment, pushing state deficits and debt

20 In a new referendum in February 2014, a narrow majority supported a constitutional amendment which will render EU rules for free movement of labor unconstitutional in Switzerland.
above EU/ECB thresholds. Conflicts over further austerity packages led to dissolution of the Center-right coalition in 2012, as the populist party (PVV) withdrew its support, but the incoming coalition of liberals and social democrats “even intensified the austerity drive, mainly to avoid the wrath of international financial markets and the disciplining measures from the European Commission” (ibid.) Consequently, populist Euro-skeptical parties on the Right and Left were surging in the polls. In spite of growing union unease, the Dutch concertation continued during the crisis. In 2010, the unions consented to a rise in the retirement age from 65 to 66 in 2020, pegging further changes to life expectancy, and, after long-term employer pressure, the unions were in 2013 forced to sign a pact reducing unemployment benefits to one year and overhauling employment protection for open-ended contracts.

In the Nordic countries, severe self-inflicted crises in the early 1990s prompted negotiated adjustments of collective bargaining regimes and social policies, alongside significant changes in macroeconomic governance.21 In contrast to most Continental countries, however, Finland, Norway, and Sweden benefited from substantial currency depreciations after their financial crises. Kick-starting export-driven economic recoveries, this enabled Finland and Sweden to reduce their huge budget deficits and unemployment without undermining their welfare states, while Norway benefited from soaring offshore revenues. The employers in the Nordic countries also pushed for decentralization of collective bargaining, and fixed-term work was liberalized in Sweden and Finland. However, due to strong trade union counter-power, employer division, and active state orchestration, mostly under Social–Democratic-led governments, the crises eventually led to renewed forms of coordinated wage restraint and stabilization-oriented economic policies, along with pension reforms and strengthened activation policies mostly based on conditionality rather than cuts in benefits.

This trajectory of negotiated consolidation and renewal of the models won broad popular support and proved largely successful—regardless of their different ties to the euro—leading the Center-right parties to give up their opposition and embrace the Nordic models in the 2000s. This eventually brought them back into office in all four countries, where the main policy changes were associated with tax reliefs, benefit retrenchment, and inroads in the union-administered unemployment funds. During the financial crisis, Sweden and Finland were among those hit hardest by the initial collapse in trade, but they rebounded fast, as did Norway. Thanks to solid public finances—and also depreciating currencies in Sweden and Norway—all countries could let the automatic stabilizers of their large welfare states work and pursue countercyclical policies, curbing the rise in unemployment. In Denmark, however, the lack of monetary policy tools due to the currency peg to the euro, alongside previous credit liberalization and pro-cyclical fiscal policies, had created an asset-driven private-debt bubble, as in the Netherlands and the UK. The collapse of the bubble brought prolonged recession, severe employment decline, and retrenchment of unemployment and other benefits in the wake of the financial crisis. In Finland, the collapse of the Nokia cluster and the global pulp and paper industries, together with tighter fiscal policies in accordance with EU recommendations, produced a renewed recession from 2012 and unemployment was still rising by Spring 2014. In spite of strains, especially in Sweden and Denmark, tripartite cooperation was largely maintained during the crisis. In Sweden, the unions in agreement with employers eventually succeeded in pressing the Center-right government to establish a public

scheme for short-time work. Faced with an upcoming election and bad polls, the government also gave in to union demands for reversal of its contested earlier differentiation of fees in the unemployment funds. The Center-right coalition in Sweden and the Social–Democratic-led coalition in Norway were re-elected in the midst of the crisis in 2009, while the Center-right coalitions in Denmark and Finland were replaced by a Red–Green coalition in Denmark and a Grand Coalition in Finland in 2011. A common feature in all four countries, however, was the rise of welfare-chauvinist, Euro-skeptical parties, posing new challenges for the dominant “catch-all” parties to both the Left and the Right. In Norway, this brought the populist Progressive Party into office for the first time, in coalition with the Conservative party in 2013.

**Diminishing Scope for Party Politics?**

It has been argued that the course of social model change in recent decades has been independent of the partisan composition of governments (Palier 2010). The above review of the case studies offers some apparent support for this view. A common explanation is that due to institutional “path dependencies” (Pierson 2000) and mechanisms of “blame avoidance” and “credit claiming” (Bonoli and Natali 2012), most governments, except in extraordinary circumstances, rely on incremental change through mixes of “layering, drift, stealth, conversion, and trial-and-error sequences” (Streeck and Thelen 2005). Another common explanation is the impact of policy ideas and discourses propelled by international agencies such as the OECD and EU (Hemerijck 2013), the importance of which evidently took a radical new turn in the Eurozone countries during the recent crisis.

Prior to the euro-crisis, there was, except in Germany, very little evidence of substantial institutional shifts or replacements, suggesting that the impact of institutional “path dependencies” remained strong. However, the relative emphasis on supply-side changes in the labor and welfare regimes, and their interrelations with demand-side-oriented economic policies and other flanking policies, were clearly influenced by the differing institutional frameworks of national macroeconomic policies. While most instances of significant social model change were triggered by economic slumps, the political and social actors’ options and repertoire for dealing the labor market effects also varied in the pre-crisis phase with the relationship to the EMU and with the size of the countries.

Countries outside the EMU—typically the UK and the Nordic countries—could, after their crises in the early 1990s, rely on monetary instruments—i.e., the interest rate and exchange rate adjustments—to redress macroeconomic imbalances, boost growth, and consolidate budgets, therefore coming under less direct pressure to shake up their social models.22 Allowing the actors to focus on labor market problems that arguably could stem from deficiencies of the welfare and labor regimes, healthy growth also made it easier to gain acceptance and support for social model reforms at the same time as growth magnified the effects of reform by greasing the wheels of labor market adjustment. By contrast, countries involved in the EMU convergence process and eventually introducing the euro had less leeway for coping with the macroeconomic parts of their problems and were to a greater extent compelled to rely on various forms of “internal devaluations” to overcome them. As pointed out by Scharpf (2012) in the German case, absent demand-side options, the only

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22 Also in Italy, depreciation after the ERM crisis spurred recovery and eased the transition into EMU.
tools left for rebalancing the economy were supply-side measures which in practice would involve cuts in the welfare state and liberalization of the labor market. In contrast to Germany, politicians in Italy and France shied away from such measures for electoral reasons and chose to rely on a mix of tax reliefs and state borrowing, which were the only remaining demand-side instruments in their macroeconomic tool-kits that could stimulate growth in the short-run. The flip-side was that such strategies magnified the longer-term growth in state debt, further constraining the scope for political choice when the Euro-crisis eventually hit. Conversely, with no monetary instruments left and foreign credits flowing in, the weak governments and fragmented social partners in Spain were politically unable to cool down the overheating economy before the bubble burst.

Thus, the structural narrowing of the available policy instruments within the EMU implied that political actors on all sides had to choose from the same restricted menu of policies, arguably making the differences in political priorities among them harder to detect. Besides leading to more frequent ousting of incumbent coalitions, this was accompanied in several countries by a rise of welfare-chauvinist protest parties. Although the EMU constraints seemed to foster more social policy convergence inside than outside the Eurozone, the country case studies do suggest that political priorities and means differed between coalitions with different composition, constituencies, and support from—and power relations among—the social partners. Similarly, Iversen and Soskiceshow that in cases with systems of proportional representation, government responsiveness to inequality-increasing economic shocks differed substantially between Nordic countries with a tradition of Center-left coalitions and Continental countries with a tradition of coalitions led by Christian-Democrats. Typically, the electoral successes of Center-right coalitions in the 2000s habitually also implied more emphasis on tax reliefs and benefit retrenchment—often combined with credit liberalization—and in the Nordic countries also initiatives to weaken union power. Besides weakened automatic stabilizers and reduced leeway to cushion the effects when the financial crisis hit, such political swings often contributed to asset bubbles that aggravated the crisis, as illustrated in Denmark and the Netherlands. Hence, the depth of the crisis and the options available to cushion it were frequently influenced by political choices and shifts in coalition-building made prior to it; contrary to the common blame on too generous welfare states, in many cases budgetary problems seemed to stem from weak ability and political will to collect enough tax revenues to fund public services.

Another lesson from the case studies is that the effectiveness of “internal devaluation” strategies clearly varies between smaller and larger countries. In Europe’s largest economy, Germany, the prolonged period of wage restraint aimed to boost export had such strong contractive effects on domestic demand that the mounting problems in the labor market and public finances in the early 2000s forced the Red–Green government to enact even harsher measures. The export-based German strategy also forced France to adopt competitive disinflation policies, spurring similar (albeit milder) contractive effects there. By contrast, several of the small states in the Eurozone, such as the Netherlands and eventually Finland, were not only able to muster broad support for wage restraint and social model change through social pacts in the 1990s, they also reaped larger benefits through

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24 Similar strategies were pursued in Ireland, Austria, and Belgium.
swift export-driven growth and budgetary consolidation while experiencing weaker boomerang effects on domestic demand, job creation, and inequality than did Germany. In line with the small states outside the EMU, such as Denmark, Norway, Sweden, and Switzerland, these countries also benefited from the advantage of closer ties and higher trust among politicians and the social actors, which, in contrast to Germany, were anchored at the peak level and embedded in long-standing institutions for tripartite problem-solving (Thelen 2013; Katzenstein 1985). However, during the euro-crisis, when the entire EU turned to austerity and adopted competitiveness-oriented small-state policies, the strong European multiplier effects clearly undermined the effectiveness of such export-oriented strategies. It is also notable that in pace with rising immigration and political skirmishes with the EU regime for coordination of social security and labor market rights, the Euro-skeptical welfare-chauvinist parties gained increased momentum in many of the corporatist small states, conquering influential tipping positions, for example in Denmark, the Netherlands, and Norway. Such dynamics were magnified during the euro-crisis when the turn to austerity and welfare retrenchment strengthened the resonance of these parties’ rhetoric and made them surge in opinion polls in France and the UK as well.

Clearly, while competitive “internal devaluations” can work for small states even in the integrated European economy, they cannot readily be replicated by the larger states or by the EU as a whole without severe social and economic costs. Yet that was precisely what the European politicians decided to do in the midst of the euro-crisis, binding each other to supranational rules, underpinned by the threat of sanctions, making austerity and “structural reforms” of social models the centerpieces of their strategy to exit the crisis. This implied a qualitative shift in the political conditions for social model change, most conspicuously when the previous issuing of “soft” recommendations was replaced by hard EU/ECB requirements of labor and welfare reform as ultimate conditions for support to debt-ridden euro-countries. Virtually reducing the governments in these countries to executors of instructions from the Troika laid down in “Memoranda of Understanding,” this implied a shift in power toward the executive branch, largely succumbing parliamentary politics to rubber-stamping of scripted policies. The consequences have been less intrusive in the countries that avoided the sovereign debt crisis, but there also the new EU regime of economic governance poses tougher constraints on the politics of social model development. Whereas social policies remained a national prerogative when the EMU was launched by Delors under the fanfares of a Social Europe, the EMU Member States have now placed themselves in a situation where their social models are at the mercy of constitutionalized, supranational rules that require permanent macroeconomic rigor from all. Through the multiplier effects in the integrated European economy such a regime is likely to restrain growth, employment creation, the funding base for the welfare states, and thus the political conditions for social model development. With prospects of downward convergence in struggling countries and likely chilling effects on standards in better-off countries, the risk is that the Treaty objective of upward convergence will give way to a scenario of aggravating divergence in the political conditions for the development of social models and labor market outcomes.

3 A “Trade-Off” Between Employment and Inequality?
Since Okun (1975) presented his notion of a “big trade-off” between equality and efficiency, the idea that higher employment would require more inequality in the labor market has tended to resurface. In the 1990s it influenced debates about how Continental Europe could overcome its “welfare without work” syndrome, and it is evidently a central element in the “structural reform” agenda of
the EU that has been imposed on the debt-stricken Member States. Built on the premise that too strict employment protection and too high wage floors exclude job seekers with limited productivity, while the work incentives for such groups are weakened by too generous benefits, greater downward differentiation of employment conditions and social benefits is called for (European Commission 2012a).

From our review of the developments in employment and inequality, it is hard to detect any systematic relationship between wage inequality and employment growth. Prior to the Great Recession, the group with the steepest rises in employment rates comprised countries with low (Finland), medium (the Netherlands), and high pay inequalities (Spain), while the group with little or moderate change in employment rates spawned both countries with large wage inequalities (Germany and the UK) and small inequalities (Sweden and Switzerland). As to the effect of changes in wage structure, there was much less employment growth in Germany, with fast-widening inequalities, than in France and Italy, where pay inequalities diminished. In the cases with strongest employment growth there was flattening wage dispersion and even decreasing inequalities at the lower end. Thus, when comparing the levels of employment and unemployment in 2008, most of the cases with lowest pay inequalities were among the best employment performers (typically the Nordic and Switzerland), while several cases with medium to high pay inequalities (France, Germany, and Spain) remained in the group with low to medium employment rates. Also taking into account the cases deviating from this pattern—Italy, the Netherlands, and the UK, showing all possible combinations of low, medium, and high pay inequality and employment rates—it is hardly possible to reveal any systematic connection between employment performance and wage dispersion, not even in the lower end where increased pay differentiation is often commended in the name of job creation (European Commission 2012a). Similarly, a comparison of 13 European countries and the USA found no correspondence across time between the incidence of low pay in a country and the total employment rate, nor did it find any direct link between the incidence of low pay and the employment rate of the low-skilled segment of the workforces (Salverda and Mayhew 2009: 139–40). 25 During the crisis the picture was equally variegated, with solid job growth both in cases with small (Switzerland, Sweden, and Norway) and large (Germany) pay inequality, while hard-hit countries saw falling employment regardless of wage structure.

The other way around, however, it is striking that the countries with the strongest job growth prior to the crisis—Spain, the Netherlands, and Finland—experienced limited or no increases in earnings inequality, especially at the lower end, in spite of highly different social models and labor market systems. Decreases at the lower end were also seen in the UK, Sweden, and Switzerland. Common to these six countries—besides solid job growth—was the fact that the supply of labor with higher education was increasing fast, mirrored in a relative decline in the share of less skilled labor. This suggests that rising demand, upgrading of skills, and tighter labor markets, *ceteris paribus*, strengthen the relative bargaining power of employees at the lower end of the job market. Conversely, the prolonged period of sluggish labor markets in Germany obviously operated in the opposite direction. Evidently, developments in wage inequality were not only influenced by changes in social model institutions and the supply of labor, but also by the rate of growth in labor demand.

25 Similarly, the OECD (2006: 165) found no relationship between high minimum wages and employment rates among persons with low skills (no secondary education); employment rates were as high in Denmark, the Netherlands, and France as in the US.
Denmark and Norway, however, can serve as indications that strong labor demand and institutions are not always sufficient to prevent rising pay inequalities when the supply of (lower skilled) labor increases sharply, as it did in the wake of EU enlargement.

Thus, when looking at employment rates, GDP growth, and disposable household income inequalities in the working-age population prior to the crisis (Figure 1), we find no indication that higher inequality is connected with higher growth in GDP or employment rates. To the contrary, all four cases with lowest income inequalities score high on both GDP growth and employment levels (upper left quadrant of the graphs), while the cases with medium and high income inequalities are scattered around in all quadrants, as reflected in the slope of the regression lines. Clearly, “there is no simple link between inequality and growth” (OECD 2012b: 194), or as concluded by a recent IMF study – “lower net inequality seems to drive faster and more durable growth” (Ostry et al. 2014: 6). Among the cases with highest employment rates, four of five have low to medium inequalities and happen to be outside the Eurozone. By contrast, among those with lowest employment rates all have medium to high income inequalities and belong to the Eurozone.

Figure 2. Change in GDP 1994-2008 (percent), employment rates 2008, and disposable household income inequality 2008 (measured by Gini index). Source: OECD.stat

The other way around, the cases with strong growth in GDP and employment rates, ceteris paribus, exhibited much lower rises in income inequality than those with low growth in employment rates, indicating that widening income gaps were often a consequence of weak growth in the labor market rather than a cause of higher growth. Viewed together, these observations are in conformity with the expectation expressed in the book’s Introduction that the effects of supply-side changes in the social models on distributive labor market outcomes are conditioned by the growth of labor demand. Further, they provide no indication that higher wage and income inequalities are associated with higher employment—lending no support to the thesis of a trade-off between equality and jobs.
4. Discussion: EMU, Social Model Change and Labor Market Outcomes

Concentrating on employment relations, this paper has provided a comparative review of changes in the European social models over the past quarter century. Central questions have been how these changes have interacted with changing economic conditions in influencing labor market outcomes; how the social models were affected by the financial crisis, and how the prior changes in them influenced the course of the crisis and the models’ capacity to cushion its effects.

Starting with the final question, the answer is straightforward. Contrary to the perception that the euro-crisis was basically a result of overly generous, rigid, and unreformed social models, the severity of the crisis evidently had less to do with deficiencies in the social models than with the deficiencies of financial market deregulation and the economic divergence generated by EMU’s economic governance structure. Any social model impact on the labor market fall-out of the crisis was dwarfed by the impact of the private debt bubbles bursting in several of the case countries—such as Denmark, the Netherlands, the UK, and Spain—and the resultant surge in public debt when governments were forced to rescue their financial system and socialize private debt. Whether the hard-hit countries were drawn into the sovereign debt crisis and forced to slash welfare budgets and employment protection also had less to do with the pre-crisis level of social spending, budgetary deficits, public debt, or employment protection than with the mounting imbalances in trade and capital flows within the Eurozone. For instance, the main casualty, Spain, modernized its social model and underwent a revolution in (female) labor market participation in the preceding decade, entering the financial crisis with a budget surplus and lower public debt and social spending relative to GDP than Germany, France, and the UK. Italy, another casualty, had done less to adjust its social model, but the share of GDP spent on social protection in 2008 was similar to that in Germany and the budget deficit was lower than in the UK, although the persistent inability to collect taxes implied that the high level of state debt, largely to Italian citizens, was not much reduced and became impossible to service when default panic gripped the financial markets. In spite of these contrasting budgetary positions, employment dropped six times more in Spain than in Italy. Next to Spain, the strongest falls in employment among our cases occurred in Denmark and the Netherlands, which had long been hailed for their “flexicurity” models and “employment friendly” welfare states. Rather than profligate social spending, the mass job losses were caused by bursting housing and banking bubbles. Fueled by “privatized Keynesianism” (Crouch 2011) politically enhanced by tax-reliefs, liberalized credit, loss of monetary instruments to curb such lending sprees, and the absence of EMU-wide regulation coterminous with the integrated financial market, the downturns were aggravated by the turn to austerity in compliance with EU rules and recommendations. A similar sequence was seen in the UK—with its prototypical liberal social model—compounding the fact that the crisis hit indiscriminately as far as social models were concerned. Yet, in contrast to the former cases, the UK could invoke monetary tools and benefit from substantial currency depreciation, bridging the slump more swiftly than the afflicted countries tied to the euro.

Although the nature of the social models had little impact on the depth of the crisis, it had significant impact on the ability to cushion the effects of the slump. Strikingly, the cases with the largest labor market fall outs—Spain, Italy, Denmark, and the Netherlands—were all distinguished by liberalized temporary work, and (except Denmark) strict protection of permanent workers. The same dualism pertained to Sweden, where unemployment in spite of healthy growth stabilized at higher levels than harder-hit countries such as Denmark. Besides withdrawal of youth labor supply, the relatively low open unemployment in Denmark reflected that it spent almost twice as high a share of GDP on active
labor market programs as any other EU country—illustrating how robust welfare states could cushion the crisis’ effects. Further striking was that actors in countries with well-organized systems of employment relations seemed more apt to negotiate innovative ways to retain labor during the trough, such as the short-time work schemes and emergency pacts flourishing, amongst others, in Germany, Finland, and the Netherlands. In Sweden, unions and employers established a similar scheme through collective bargaining. The tax and transfer systems’ ability to cushion the income inequality effects of unemployment varied starkly between cases with encompassing welfare systems, typically the Nordic, Dutch, and French, and the more patchy unequal systems in Italy and Spain where sweeping cuts during the crisis magnified the effects. Still, as witnessed in France and Nordic countries, hardly any social model can curtail the disparities arising from mass job losses and prolonged, high unemployment. While prior changes had weakened the automatic stabilizing and cushioning effects of tax and welfare systems, the impact was—especially in the countries subject to treatment by the Troika—aggravated by the welfare cuts ensuing from the EU shift to austerity. Contrary to the diagnosis implied by the EU/ECB recipe for austerity and “structural reform,” our study suggests that countries with well-organized systems of employment relations and skill formation, relatively un-segmented labor markets, and encompassing welfare states with adequate tax and funding systems, ceteris paribus, were better equipped to weather the crisis than countries with leaner and less coherent social systems.26

Turning to the question about the links between social model change and labor market outcomes, the comparison of pre-crisis developments shows that the impact of institutional supply-side changes on employment and inequality is highly dependent on the development in labor demand. Absent sufficient demand, the partial deregulation of labor markets and the associated erosion of employment relations seen in many of the cases had limited employment effects but strong effects on inequality. A case in point is the surge in inequality following such changes during the prolonged period of sluggish growth in Germany up till 2005. Also in instances of healthy growth easier access to temporary work seems to have little effect on net employment (OECD 2012a), but broadened access to jobs and earnings can offset income inequality effects as illustrated during the employment “miracles” in Spain and the Netherlands—and lately in Germany. Evidently, demand growth adding to employment curbs inequality, indicating that the “high employment route to low inequality” can work (Kenworthy 2008). The contrasting effects of activation policies in slack and tight labor markets point in the same vein. In contexts of sluggish labor demand, activation readily became a revolving door at the same time as the weakening of the bargaining power of low-skilled workers in many instances was reinforced by partial deregulation, erosion of collective agreements, and benefit cuts reducing reservation wages. With declining unionization almost everywhere, it is notable that pay inequalities in the lower half of the distribution seem to widen less in cases with extension of agreements and/or statutory minimum wages. Otherwise, wage setting often becomes an asymmetric affair between the employer and individual workers, as indicated by the widened wage inequalities in Germany, Denmark, and Norway.

26 Defining labor market “resilience” as the extent to which “labor markets weather economic downturns with limited social costs” in terms of “unemployment, labour income and earnings inequality,” a similar conclusion is drawn by the OECD (2012a: 54). In models with weak or no coordination of wage bargaining and liberal rules for, and high shares of, temporary work (typically Spain), a given drop in GDP has a much stronger negative impact on resilience than where bargaining is more coordinated and non-standard employment is more regulated.
Altogether, our comparative analysis of the pre-crisis period lends limited support to the supply-side diagnosis dominating European labor market debates the past decades. As there was no association between the increase in employment and the level of inequality across countries, we found no evidence of a trade-off between equality and jobs. The Nordic countries still stood out, with the lowest inequalities and highest employment levels measured in worked hours relative to working-age population. While clearly, “there is no simple link between inequality and growth” (OECD 2012b: 194), evidence compiled by the IMF seems to suggest that higher net inequality hampers growth (Ostry et al. 2014: 6). Neither do our findings lend support to diagnoses focusing solely on the demand side. Labor market outcomes are obviously influenced by demand—as demonstrated during the recent crisis—but the vast pre-crisis variations in the employment effects of growth were clearly influenced by supply-side factors. The “employment miracles” in Spain, the Netherlands, and lately in Germany were enabled by prolonged, solid growth, but they could hardly have been sustained without the untapped reservoirs of labor supply among women in particular. As viewed in the Nordic countries a few decades earlier, investment in social models enabling broader labor market participation, skill formation, and combination of work and family life evidently contributed to the supply-side responsiveness to the rise in demand. That similar dynamics did not occur in Italy, France, and Germany in the 1990s and early 2000s compounds that sufficient demand is indispensable to mobilize untapped labor supply and boost employment. In conclusion, our findings are in conformity with the thesis that labor market outcomes are determined by the interaction of supply- and demand-side dynamics (Blanchard and Wolfers 2000).

In this view it may appear as a paradox that the EU, during a recession unleashed by collapsing demand in the wake of financial meltdown, has refurbished the supply-side diagnosis and made “structural reform” its main tool to overcome the labor market crisis. This brings us back to the political dynamics and frameworks that have shaped the variations in social model change. The two phases of change evolved through political responses to two major economic and employment crises that threatened the financial viability of the welfare states. Initially the adjustments were shaped by variations in national institutions, politics, and party coalescing. Gradually, however, the process of monetary integration altered the political frameworks for economic policies and social model adjustment, varying significantly between countries inside and outside the EMU. Whereas the latter have been able to continue invoking national monetary tools, including exchange rate adjustments, to overcome economic shocks, the former, after ceding monetary policies, have successively become subject to stricter constraints in fiscal policies too. Their main means left to recover from economic shocks or dampen cyclical swings are therefore “internal devaluations,” i.e., adjustments in tax and transfer systems, wage setting, and the labor market pillars of the social models. Due to such differences in political frameworks and the available tools to counter economic volatility, the evolving patterns of social model change have differed markedly between our case countries inside and outside the Eurozone. In the latter countries monetary policy has eased the pressures on the social models—eventually also shielding them against the sovereign debt crisis—mainly leading to incremental adjustments in the social models. Absent national monetary policy, social model development in the Eurozone countries has become much more directly affected by macroeconomic volatility and has been strongly influenced by growing economic divergence. After the reunification crisis, strong growth gave ample room for development of the social models in Finland, the Netherlands, Spain, and other countries in the EMU periphery, in contrast to the large core countries struggling with low growth. Combined with the reunification shock, this prompted the drastic
overhaul of the German social model. In the second phase, the economic divergence and ensuing debt crisis opened new social and political cleavages in the EU. While the Southern countries that fell victim to the sovereign debt crisis were set under administration by the Troika and forced to make drastic inroads in their social models, the Northern “surplus” countries were still able to comply with the tightened EMU rules by means of limited “social devaluations”.

5. Future prospects
Common to all, however, is that the weight-shift between national and supranational politics, and the multiplier effects of the permanent austerity regime installed by the EU, will reshape social model evolution in ways rendering earlier analyses of the EU as a rescue of the national welfare state obsolete (Milward 1990; Ferrera and Gualmini 2004). Although the burial of the European social model alluded to by ECB President Draghi (Wall Street Journal, February 2012) may be precipitated, the adopted EU strategy appears—contrary to Treaty objectives—to be a recipe for a multi-tiered Social Europe on a downward slope. In such an outlook the divergence in the political and economic conditions for development of the social models among debt-stricken euro-countries, better-faring euro-countries, and countries outside the Eurozone is likely to deepen. Across these tiers, however, economic spill-overs, “regime competition,” and rising movements of labor and services can be expected to put a chill on improvements in better-off countries also, and entail an obvious risk for a scenario of downward convergence. With prospects for a protracted, slow, and uneven recovery, this suggests that most national politicians and social partners will have to fight over distribution of burdens and sacrifices rather than improvements. If so, the EU response to the crisis may turn out to be a turning point whereby the past 50 years of social progress gives way to dynamics of social division and regression that may spread throughout the EU and beyond. The looming risk is that such dynamics will also make more people turn their back to European integration and the political cooperation across borders that, more than ever, are needed to bring Europe onto a new course.

References


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