

CHAPTER 6.

The Self-transformation of the European Social Model(s)

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6.1 THE EUROPEAN SOCIAL MODEL

European welfare states are in varying need of reform. Intensified international competition, ageing populations, de-industrialisation, changing gender roles in labour markets and households, and the introduction of new technologies, all pose severe strains to welfare state programs designed for a previous era. Identifying new social objectives with no regard to their practical political relevance and implementation within diverse European welfare models, would remain a sterile academic exercise. For this reason the analytical focus in this final chapter shifts from the ‘problem-oriented’ question: “What sort of new welfare architecture is required in the face of the strains of transformation?”, to the ‘political-institutional’ question: “What kinds of policies are feasible and fair, given the tremendous differences in welfare state design and in decision-making structures across Europe?”

All European welfare states share three distinctive characteristics. Normatively, there is a common commitment to social justice. The vocabulary of reform is in most member states couched in terms of a solidaristic commitment that society will not abandon those who fail. The preference for minimum guaranteed resources is widely accepted by European publics and deeply entrenched in policy program and institutions. The stigmatising discourse of the ‘deserving’ versus ‘undeserving’ poor never really gained currency in the European Union, apart from the Thatcher era in the United Kingdom in the 1980s (Schmidt, 2000).

At the cognitive level, the European social model is based on the recognition that social justice can contribute to economic efficiency and progress. As a ‘beneficial constraint’, a term coined by Wolfgang Streeck, social policy can reduce uncertainty, enhance the capacity to adjust and the readiness to accept change, bear more risks, acquire more specialised skills, and pursue investment opportunities. Social policy also serves to

create and stabilise collective goods, channel and mitigate industrial conflict in periods of structural adjustment, and, in turn, foster political stability and social cohesion (Streeck, 1992; 1997). Last but not least, it should not be forgotten that with social protection outlays averaging 28% of GDP in the EU, social policy acts as an effective anti-cyclical stabiliser (Begg et al, 2001). Against the neo-liberal assumption of a big ‘trade-off’ between economic efficiency and social justice, European policy elites agree that social policy is an essential factor in promoting economic adjustment, that there is no contradiction between economic competitiveness and social cohesion.

The European social model is marked by high degrees of interest organisation and comprehensive negotiations between the government and the social partners over conflicts of interests in matters of economic and social policy. Compared to North America, industrial relations are stable; the majority of workers are covered by collective agreements determining working conditions, employment protection, and living standards. Social partnership, with ‘trust’ as a constitutive element, moreover, encourages a problem-solving style of policy making, rendering collective actors the necessary social capital to overcome sectionalist interests (Swank, 2001).

Bounded policy innovation

Since the late 1970s, all the developed welfare states of the European Union have been recasting the basic policy mix upon which their national systems of social protection were built after 1945 (Scharpf and Schmidt, 2000; Ferrera and Rhodes, 2000; Kuhnle, 2000; Pierson, 2001). In the 1970s, in address to the threat of stagflation, policy adjustment primarily revolved around macro-economic management and wage bargaining to counter spiralling cost-push inflation and demand-gap increases in unemployment. After the mid-1980s, policy attention moved towards issues of economic competitiveness. In employment policy there was a decisive shift towards supply-side measures. Next to initiatives of labour market deregulation, many welfare states tried to contain open unemployment by reducing labour supply, mainly via early-retirement and disability pensions (Ebbinghaus, 2000). The destabilising consequences of large-scale early retirement and other forms of paid inactivity were only perceived as major policy problems when the European Monetary Union set limits to deficit and debt financing. In the wake of the Maastricht Treaty, politicians adopted measures of cost-containment, often in conjunction with the introduction of more proactive labour

market policies. The institutional makeup of social security arrangements also became a target for reform in the 1990s (Hemerijck and Schludi, 2000).

In retrospect, it is perhaps surprising that policy reforms in the core 'distributive' areas of the welfare state arrived so late in the process of adjustment. The answer is largely political: the more that reform embraces core 'distributive' areas of social protection, the more political conflict is likely to flare up. A change in macroeconomic policy is less likely to ignite conflicts than are cuts in social security benefits. And as social rights are usually attached to strong interest groups, political opposition is likely to render the reform process unpredictable (Pierson, 1994). If wages are sticky, as economists argue, then policies of social protection, enshrined in law, are probably even stickier. This is perhaps most true for pension benefits, which are regarded by large majorities as 'sacrosanct rights' of the elderly (Myles and Pierson, 2001).

We live in a world of path-dependent solutions, and radical change in Europe's welfare states is institutionally ruled out. The challenge is not so much to design, in the abstract, a completely new welfare architecture, but to *recast* prevailing social and economic policy to make them more responsive to the new demands of post-industrial economies. Throughout the neo-liberal 1980s it proved difficult to launch a successful attack on the mature welfare states, especially in Western Europe. Growing citizen disenchantment with neo-liberal recipes subsequently led to political reversal in the 1990s. Voter reaction against the social costs of widening wage disparity and rising poverty revealed a deep popular commitment to their welfare states. This helped return social democratic parties to office in the majority of West European polities, including the four largest countries.

Welfare state popularity does not preclude change. Welfare states are not 'immovable objects' as many observers assert (Pierson, 1998). Even groundbreaking policy changes were implemented in many countries over the past two decades. Moreover, welfare state futures are not foreordained. Path-dependency is about historical contingency: no more, no less. It is indeed striking how many reforms have been enacted in the past decade and how little they followed the textbook neo-liberal recipes (Ross and Martin, 2002). The impact of EMU on social and employment policy is a case in point. Many of the architects of EMU believed that the new macroeconomic environment would, by erecting massive constraints, trigger 'structural reforms' in labour markets, collective bargaining systems, social protection programs, and in welfare financing. To be sure, the shift to a single currency engendered important direct and indirect repercussions

on wage bargaining and social policy. Centre-left parties, back in office during the run-up towards EMU, could definitely not achieve their aspirations of social justice and full employment through traditional expansionary 'demand-side' policies. This was not tolerated by the Maastricht Treaty (1992) or, later, the Stability and Growth pact (1997). As a consequence, social democratic governments were forced to adopt more painful policy prescriptions. Many embarked upon novel agreements with the social partners, reminiscent of corporatist exchanges between the trade unions and employers organisations in 1970s.

Common post-industrial challenges impose quite divergent problem loads from one welfare state to the next. This reflects heterogeneous economic development and social structure, but, more crucially, different social policy legacies, distinct systems of interest organisations and democratic institutions. We identify three welfare regimes, each with a rather unique welfare design and institutional attributes: a Nordic, an Anglo-Saxon, and a Continental European model. The three vary significantly in their relative vulnerability to the new challenges of post-industrial change. The Scandinavian welfare state faces a 'flexibility' problem of creating the appropriate conditions for an expansion of private services. This is closely related to fiscal pressures. The Anglo-Saxon countries face increasing social exclusion of both the 'working' and 'non-working' poor, even in a booming labour market. The Continental countries suffer from low employment rates, especially among women and elderly males, and are especially pressed to transform their inclusive pay-as-you-go pension systems. The Mediterranean welfare states are additionally faced with the difficult task of weakening their traditional "familialism". Although the principal site of reform and policy innovation is the nation-state, the process of reform is no longer exclusively a national affair. Today social and employment policies are, under conditions of growing international economic and political interdependence, severely constrained by the Economic and Monetary Union (EMU) and increasingly shaped by initiatives like the European Employment Strategy (EES). The impact of European integration on domestic employment and social policy reform in the fifteen member states therefore features prominently in this final chapter.

The character of the reforms pursued under Centre-Left governments in the 1990s is best captured in terms of institutionally bounded policy change. Most of the policy changes in wage bargaining, employment policy, social services, and pensions have evolved through experimentation. As prevailing employment and social policy ran into severe problems of sustainability, because they were built on political, economic,

demographic, and household conditions that no longer prevailed, this triggered a dynamic of *renovation* and *re-casting* current policy so as to achieve a better “fit” with new societal challenges and pressing economic constraints. The precise policy mixes that have ensued have not only been critically shaped by past policy legacies and institutional structures of decision-making, but also by policy makers’ capacity for *innovation*, intelligently using the policy resources at their disposal (Crouch, 2001).

Many reform efforts across Europe during the ‘social democratic moment’ of the 1990s were couched in terms of the idea of “social protection as a productive factor”. The challenges of post-industrialism should be met by novel synergies between social policy and economic policy (Kaufmann, 2001). As noted, essentially all European governments agree that comprehensive welfare policy is a ‘productive factor’ in the competitive knowledge-based society (European Council, 2001). This is captured in the normative commitment, formulated at the Lisbon Summit (2000): ‘to become the most competitive and dynamic-knowledge based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’. Institutionally, moreover, it is again generally accepted that a productive balance between economic and social policy is best achieved through a dialogue with the social partners, also at the level of the European Union.

The rest of this chapter is divided into five parts. In part 2, I highlight the main characteristics and vulnerabilities of the three welfare regimes. They all represent a different manifestation of the so-called ‘service sector trilemma’ (Iversen and Wren, 1998). This trilemma suggests that welfare states today confront a tough choice between full employment, income equality, and fiscal restraint. In part 3, I present the notion of *bounded policy innovation* and turn to examine available policy responses and concrete experiences of policy innovation in four key policy areas. These concern, respectively, adaptations in wage bargaining in the shadow of EMU, different approaches to activation at the interface of labour market policy and social insurance, policies enabling parents to combine career and family life, and, last but not least, efforts at making pensions both sustainable and fair in the face of ageing. In part 5, I finally examine the potential contribution of the EU to employment and social policy reform to the ongoing process of *self-transformation of the European social model(s)*.

6.2 WELFARE REGIMES AND THE ‘SERVICE SECTOR TRILEMMA’

Each welfare state displays unique features in policy design, based on deeply held national aspirations of equality, social justice and solidarity. Since the Second World War, the expansion of social security, social services, pension rights, minimum wages, collective bargaining procedures and dismissal protection, was a fairly autonomous domestic political affair. In terms of policy design, European welfare states vary significantly along several dimensions (Esping-Andersen, 1990; Scharpf and Schmidt, 2000; Ferrera *et al*, 2000).

- *Eligibility and risk coverage.* Access to provisions of social protection can be based on citizenship, need, work-related contributions or private contracts.
- *Benefit structure and generosity.* Benefits can be generous or minimal, means-tested, flat-rate, earnings-related, or contribution-related. Benefit structure is also related to country-specific objectives of social protection: income maintenance, poverty alleviation or equality.
- *Methods of financing.* Financing can range from general taxation, payroll-contributions, and user charges, or some combination thereof.
- *Service intensity.* Social services can be provided for through professional (public) services, through the market, or, informally, by the (extended) family.
- *Family policy.* Family policy can be passive, with a strong emphasis on cash transfers in support of traditional single breadwinner family patterns, or very active in its support for gender equality within and outside households with a strong emphasis on servicing through public day-care and generous parental leave provisions.
- *Employment regulation.* Under the heading of employment policy and regulation we group together highly diverse set of ‘industrial rights’, such as employment protection (e.g. in the case of dismissals), (minimum) wage regulation, collective bargaining rights and procedures, work council’s, and active labour market policies.
- *Logic of governance.* Management of welfare and employment policy does not necessarily fall within the jurisdiction of national public administration. Of special importance is local administration and the degree of extra-parliamentary institutional integration of the social partners (representatives of employers and employees) and private or ‘third sector’ sector parties in the management and delivery of welfare policy.
- *Industrial relations.* Closely related to the employment regulation and logic of governance in social and employment policy, is the degree of co-ordination in

national systems of industrial relations, ranging from fragmented unco-ordinated systems to sectoral pattern bargaining and centralised co-ordination. Co-ordination in industrial relations is crucial to employment, primary income distribution, and the extent which externalities like inflation and unemployment can be mitigated through co-operation (Crouch, 1993; Traxler et.al., 2001; Scharpf, 2000a).

The rich literature on welfare 'models' has shown how these variables are systematically related to one another, producing distinctive, but not exclusive, nation clusters. Basically we can distinguish between three different 'social Europes' (Esping-Andersen, 1990; 1999). The comprehensive Scandinavian welfare states are characterised by (1) citizenship-based universal entitlements; (2) generous replacement rates in transfer programs; (3) general revenue financing; (4) a broad supply of social services beyond health and education, (5) active family policy encouraging gender egalitarianism and women's integration in the labour market; (6) low (Denmark) to high (Sweden) levels of employment protection, with a strong emphasis on active policies and training programs linked to general education; and (7) corporatist industrial relations with peak level bargaining, strong unions and high levels of collective bargaining coverage. Historically, Scandinavian welfare states featured a strong commitment to full employment macroeconomic policy.

The Anglo-Saxon model, more guided by utilitarian market principles, is characterised by (1) a bias towards targeted, needs-based entitlements ; (2) low replacement rates in transfer programs; (3) general revenue financing; (4) underdeveloped public social services beyond health and education; (5) poor family services; (6) low levels of employment protection, largely confined to ensure fair contracts, and no legacy of active labour market policy, nor vocational training and education; (7) uncoordinated industrial relations with moderately strong unions, decentralised wage bargaining, and low levels of collective bargaining coverage.

The Continental European model, historically influenced by a mix of *etatiste*, corporatist and familialist traditions (Kersbergen, 1995), is characterised by (1) occupationally distinct, employment-related social insurance ; (2) very unequal levels of generosity in transfer programmes, combining generally very high pension replacement rates with occasionally very modest income support (such as unemployment benefits in Italy) ; (3) a contribution-biased revenue dependency; (4) very modest levels of public social services beyond health and education and often a considerable reliance on 'third sector' and private delivery; (5) passive family policies

premised on the conventional male breadwinner family; (6) generally strict levels of employment protection, that is meant to protect, once again, the male breadwinner combined with passive labour market policies, but comprehensive systems of vocational education and training, especially in Germany, Austria, and the Netherlands.; (7) strong social partnership that extends into the administration of social insurance; and (8) co-ordinated industrial relations, with a predominance of sectoral wage bargaining, with high levels of bargaining coverage and moderately strong unions.

Differences in policy design are closely related to variations in employment performance, service intensity, levels of income inequality, and also to structures of taxation. On the employment side, the Nordic countries outperform both the Anglo-Saxon and Continental models. See Table 6.1. Ireland and the United Kingdom display favourable levels of employment with relatively low rates of public employment (but in Ireland, female employment is very low). The Continental European countries present a mixed picture, with above average employment performance in the North-Western part of the European continent, including Austria, Belgium, France, Germany, the Netherlands and Luxembourg, and very low employment rates (especially among women and older workers) in the Mediterranean countries (Portugal being an exception).

Table 6.1: Employment performance in the European Union (2000)

	Employment rate ^a	Un-employment rate ^b	Long-term unemployment ^c	Female employment rate	Youth un-employment rate ^e	Activity rate, men aged 55-64	Public Employment Ratios ^d
Denmark	76.3	4.7	1.0	71.6	5.3		22,7
Finland	67.5	9.8	2.8	64.4	11.2		14,6
Sweden	73.0	5.9	1.3	71.0	5.5		21,9
Austria							
Austria	68.3	3.7	1.0	59.4	2.9		10,0
Belgium							
Belgium	60.5	7.0	3.8	51.5	6.5		10,3
France							
France	62.2 ^f	9.5	3.8	55.3 ^f	7.1		14,5
Germany							
Germany	65.4 ^f	7.9	4.0	57.9 ^f	4.6		9,3
Greece							
Greece	55.6 ^f	11.1	-	40.9 ^f	-		6,9
Italy							
Italy	53.5	10.5	6.4	39.6	11.8		8,9
Luxembourg							
Luxembourg	62.9 ^f	2.4	0.6	50.3 ^f	2.5		-
Netherlands							
Netherlands	73.2 ^f	2.7	0.8	63.7 ^f	3.6		6,8
Portugal							
Portugal	68.3	4.2	1.7	60.3	4.2		12,0
Spain							
Spain	55.0	14.1	5.9	40.3	11.4		7,5
Ireland							
Ireland	65.1	4.2	1.7	54.0	3.3		9,3
UK							
UK	71.2	5.5	1.5	64.6	8.3		9,5
EU 15							
EU 15	63.3	8.2	3.6	54.0 ^f	7.8	69.0 ^f	11,7

^aTotal employment/population 15-64 years; ^b Standardized Ratio; ^c Long-term unemployed (12 months and over) as % of labour force; ^d % of population 15-24, 1998; ^e Unemployed as % of population aged 15-24; ^f Eurostat estimation.

Source: *Employment in Europe 2000*, European Commission, 2000a; OECD (1999a) (Public employment figures)

With respect to social expenditures, the Nordic countries, as shown in Table 6.2, are by far the most generous, followed by Continental Europe with the Anglo-Saxon countries occupying the low end. The spending bias differs, however. The Mediterranean countries are very pension biased, most notably in Italy where pensions absorb 16.13% of GDP. In contrast, the Nordic welfare states are unusually biased in favour of social services to families and children.

Table 6.2: Levels of Social Security, Active labour market policy, and Collective Bargaining Coverage in the European Union

	Social expenditures in percent of GDP ^a	Total taxation ^b	Old Age and Survivors as percent of GDP ^a	Family/Children as % of GDP ^a	Social exclusion ^c 1995	Active labour market policy ^d	Labour market training ^e	Coverage Collective Wage Bargain ^d
Denmark	30.0	52,2	11.49	3.90	1.1	2.01	0.48	0,52
Finland	27.2	47,3	9.38	3.48	0.4	1.66	0.21	0,67
Sweden	33.3	53,3	13.12	3.60	0.1	0.87	0.28	0,72
Austria	28.4	44,4	13.69	2.84	1.5	1.89	1.07	0,97
Belgium	27.5	46,5	11.77	2.34	0.7	1.23	0.41	0,82
France	30.5	46,1	13.42	2.99	0.3	0.42	0.09	0.75
Germany	29.3	37,5 ^c	12.69	3.03	0.3	0.44	0.15	0,80
Greece	24.5	40,6	12.89	1.98	0.7	1.29	0.29	-
Italy	25.2	45,0	16.13	0.91	0.6	1.27	0.34	-
Luxembourg	24.1	-	10.65	3.40	0.4	0.30	0.01	-
Netherlands	28.5	43,3	11.71	1.28	0.7	1.76	0.22	0.79
Portugal	23.4	34,5	9.99	1.24	-	0.35	0.06	0.80
Spain	21.6	35,3	9.96	0.45	0.0	1.08	0.01	0.67
Ireland	16.1	34,8	4.01	2.04	0.5	1.37	0.35	-
United Kingdom	26.8	35,3	11.77	2.30	0.1	0.72	0.21	0,35
Average	27.7	42,6	12.66	2.30	0.5	1.1	0.27	

^a1998 ^b1997; ^c1996; ^d1995, workers covered, figures not including Greece, Italy, Luxembourg, and Ireland; ^e1995 data, or latest year available; .

Sources: ^a“Statistics in Focus: Social Protection in Europe,” Theme 3-15/2000.

Eurostat (2000); ^bOECD (1999c): *Benefit systems and work incentives*, own calculations; ^cEC (there may be some overlap with other categories of expenditure);

^dVisser, 1999.

What follows, quite surprisingly, from these figures is that the relation between distributive results, employment performance, and tax-spending levels is very weak. The most redistributive welfare states (Denmark and Sweden), have the highest tax burdens, and do better in terms of employment than the low-tax Anglo-Saxon countries. The medium-high tax Continental welfare states and the moderate-low tax Southern welfare states perform worst in terms of employment, and also in terms of redistribution. Indeed, the low rates of employment in Continental Europe have less to

do with the overall level of taxation and more to do with the heavy reliance on social security contributions.

Persistent unemployment remains the Achilles heel in most European economies. Although it has declined from its peak of 11.1% in 1994 to less than 8% in 2001, long-term unemployment remains at 4% of the labour force. More than 40% of European unemployed people have been out of work for more than a year. Youth unemployment, at 8.4% in 2000, is only two percentage points lower than in 1994.

Employment growth, like everywhere, is skill-biased, service intensive, and gender-specific. The highly educated workers are the winners, both in terms of job security and pay (Lawrence and Slaughter, 1993; Freeman, 1995). The low skilled and less experienced workers are the losers; they either face declining wages, as in the U.S., or rising difficulties in finding employment.

High skill jobs account for two-thirds of net employment creation since the mid-1990s. Between 1994 and 1999, over 60% of the 6.8 million new jobs in the European economies went to women (European Commission, 2000a). The majority of newly employed women in the 1990s has taken up service related jobs. Employment levels of workers over 55 continue to decline in the larger economies of Germany, France, and Italy, while in the Netherlands the employment rate of men over 55 rose by 5.5 percentage points over the past decade.

The problems which beset different welfare regimes are inevitably connected to the nature of de-industrialisation, and the rise of the service sector. In particular, countries differ substantially in terms of the longer run dynamics of exposed and sheltered sectors (Scharpf, 1997a). Since the mid-1970s, European economies, with the notable exception of the Netherlands and Ireland, have experienced substantial employment decline in the exposed sectors, especially in agriculture, mining, manufacturing and transport. Sweden and Finland stand out in terms of suffering a continuous loss in industrial employment. In other member states, employment in the exposed sector has stabilised at a rate of about a third of the working population.

The decline of jobs in the exposed sectors is probably less related to competition from Third World markets (considering that the rest of the world accounts for only a small proportion of European trade) than to the removal of regional barriers to the free movement of capital, firms, goods and services by the completion of the European

internal market. This has required the economies of Sweden, Germany and the Netherlands, for instance, where wage costs are high, to exploit all opportunities of increasing the efficiency of production and the quality of innovation. To the extent that employment in the exposed sectors has remained stable since 1985, the decline in low-skilled jobs has been offset by significant increases in highly skilled jobs (Scharpf, 1997a).

Within the sheltered sectors, employment depends mainly on the expansion of domestic services, like wholesale and retail trade, restaurants and hotels, community-, social-, and personal services. These, in theory, should be dynamic given the new demand structure that comes from population aging (health, care services, and recreation), from household transformation (dual career households are more inclined to buy personal services), and from increased female employment which generates demand for “reproductive” social services, such as childcare.

The combination of de-industrialisation, the rise of the service sector, and the fiscal constraints that derive from the EMU, pose a thorny trilemma. Iversen and Wren (1998) argue that the goals of high levels of employment, income equality, and fiscal restraint can no longer be achieved simultaneously. The ability to maximize service employment today depends on a number of constraints, all of which are linked to the nature of national welfare systems (Scharpf, 2000):

- International competition is driving up productivity and skill requirements in the exposed sector, and this means that most employment growth will be biased in favour of medium and high skilled jobs, while the low skilled will continue to shrink (Wood, 1994).
- The loss of jobs in exposed sectors can be offset by employment gains in the sheltered service sectors, which can be either private or public. However, public employment is stagnant, in large part because of the fiscal constraints associated with the EMU and, subsequently, the Stability and Growth Pact. Job opportunities in private social services are on the rise, but their growth potential is constrained by welfare state regulation of private provision (Scharpf, 2000).
- For the less skilled, employment opportunities are doubly constrained. On one hand, well-paid public sector jobs are stagnant. On the other hand, the growth of private services, such as retail trade, restaurants, and personal services, are constrained by prevailing levels of social protection, the size of the minimum wage,

and by the high tax wedge that derives from heavy payroll contributions or from general taxation.

The service sector trilemma generates quite distinctive policy problems for different welfare systems. It is worth summarising these regime-specific problems before we go on to assess policy responses in the areas of wage bargaining, labour market policy, social services and pensions.

The Scandinavian problem

The Scandinavian welfare states are undoubtedly expensive in terms of revenue requirements. Nonetheless, they are demonstrably better adapted to the exigencies of post-industrial change – in large part due to their service intensive, women and child ‘friendly’ public policy profiles.¹ Social exclusion due to poverty and long-term unemployment is largely avoided. Denmark and Sweden embarked on the road to high public employment already in the 1960s, and what emerged was a self-reinforcing mechanism whereby the expansion of ‘welfare state jobs’ encouraged women and lone parents to enter the labour market. As the welfare state ‘de-familised’ many caring functions it also fostered demand for more social services. The net result was near-maximum employment among men and women alike, less early retirement, and relatively high birth rates, all helping to reduce the long-term financial strains on pension systems.

The main difficulty confronting the Scandinavian model is that financing the welfare state is made more difficult due to high capital mobility, the fiscal and budgetary constraints that aging and European monetary integration impose, and increased political tax resistance (Hemerijck and Schludi, 2000; Scharpf, 2001). Since the 1980s, tax revenues as a share of GDP have been stagnant and, consequently, so has public employment. Indeed, with falling tax revenues during the 1990s, public employment fell markedly in Sweden. There is a clear need to expand private sector jobs to compensate for losses in public sector employment. This is where the trilemma raises its head: the Nordic countries face the hard choice between liberalizing private services, which entails more wage inequality, or a continued adherence to wage equality which, under conditions of budget constraint, implies more unemployment.

¹ For details, see chapters 2 and 3 in this book.

The Anglo-Saxon problem

The Anglo-Saxon experience represents a response to the trilemma which has sacrificed egalitarian goals for the sake of jobs and budgetary restraint. New Labour in effect rejects the pursuit of greater equality via redistribution on moral grounds. The central feature of New Labour's egalitarianism is to promote more earnings income via employment.

The Anglo-Saxon welfare states are comparatively far less threatened by long-term problems of financial sustainability. The conservative adjustment strategy adopted in the UK encouraged wage inequalities and an expansion of low paid jobs. The result has been a significant polarisation of incomes, coupled to an ever-more unequal access to social insurance. Those who can afford private insurance are well-covered, while those who cannot are at risk of poverty.

The rise of female employment is, however, not accompanied by active attempts to diminish gender inequities. In the U.K., the absence of quality day care provision means that women are frequently compelled to accept low-quality part-time work (Stewart, 1999). And as we have seen in Chapter 2, there has been a marked increase in child poverty and inequality over the past twenty years. Wage subsidies have been introduced to supplement the incomes of low paid workers and their families (Clasen 2001). Moreover, radical labour market deregulation has rendered the British system of industrial relations incapable of engaging in co-operative relations between management and trade unions, and it has not helped remedy Britain's longstanding inability to produce a well-trained labour force (Finegold and Soskice, 1988). Skill shortages, low wages and poverty have produced cumulative cycles of social disadvantage and exclusion of vulnerable groups (Glyn and Wood, 2001).

The Continental European problem

The Continental European welfare states represent yet another version of the service sector trilemma. Here, a main obstacle to private job growth lies in high wage floors – largely created by very high fixed labour costs. At the same time, public employment is constrained by the fiscal burden of supporting a very large inactive population.

The vulnerability of most Continental welfare states lies less in the Anglo Saxon ills of widespread poverty and problems of skill-formation, and more in their chronic inability to stimulate employment growth. Job stagnation is directly related to the particular

method of pay-roll based social insurance financing (Esping-Andersen, 1996; Scharpf, 1997a). This breeds a complicated, mutual interaction between investments, productivity, labour supply, and wage costs. The key to this interaction lies in the strategy of boosting international competitiveness via a combination of early retirement and raising productivity levels of workers through high-quality vocational training and education. The strategy may have put a premium on high productivity, but the indirect effect has been a substantial increase in the 'tax' on labour, as ever fewer workers must shoulder ever more inactives. Put differently, maximizing worker productivity may have resulted in a general 'inactivity trap', whereby a virtuous cycle of productivity growth coincides with a vicious cycle of rising wage costs and exit of less productive workers, all requiring further productivity increases and eliciting another round of reductions in the work force through subsidised early retirement exit. The inactivity trap of the Continental welfare states reinforces existing 'insider-outsider' cleavages and social exclusion, especially where labour markets are heavily regulated, as in Southern Europe (Ferrera, 2000; Guillen et al, 2001).

The primary victims of this self-reinforcing negative spiral have been the young and women (women with children, especially). This goes a long way to help explain fertility and labour supply patterns. As we have seen in Chapters 2 and 3, birth rates are low because of a) difficulties among youth to gain a firm foothold in labour (and housing) markets, and b) the absence of affordable child care. Hence, women especially are faced with a naked choice between participating or forming families. Hence also the protracted dependency of youth on their parents, in Southern Europe especially (Trifiletti, 1999). Like elsewhere, with rising education women's preferences have changed dramatically. But unlike elsewhere, the institutional environment has remained 'frozen' in the traditional male breadwinner mold. In brief, overall job stagnation is worsened by the severe incompatibilities that women face when they opt for a career.

Yet, far higher female employment rates are needed not only to counteract population ageing, but also to reduce household poverty risks. Of course, the low levels employment imply also that the Continental welfare states have a vast unused labour force potential which, if mobilized, may help sustain future welfare state finances.

Countries all face the service sector trilemma in one form or another. Still, we should avoid exaggerating its actual ramifications. More concretely, it may act as a general constraint but it is not necessarily insuperable. Over the past decade, some countries,

among them Denmark and the Netherlands, have managed to increase service jobs while essentially returning to full employment *without* abandoning their commitment to either wage equality or fiscal restraint. Indeed, both countries have in recent years built up substantial budget surpluses. This also applies to Sweden and Finland which, considering the deep economic crisis of the 1990s, confronted intense budgetary strains *and* a rise in unemployment.

6.3 BOUNDED INNOVATION IN THE WELFARE STATE

Welfare reform is difficult, but it happens. Feasible policy reforms are conditioned by at least three distinct sets of causal factors. These are: 1) the relevant policy challenges; 2) differences in structures of political decision-making; and 3) variation in welfare state design (Scharpf and Schmidt, 2000).

As we have shown in the first four chapters of this book, European welfare states face similar challenges and, yet, these do not seem to lead to convergent policy responses. The neo-institutionalist approach to comparative social policy assumes a relatively tight connection between path-dependency and policy inertia: there is a 'lock in' effect, whereby policy choices made in the past become difficult to reverse, even in the face of serious external pressures. Institutional arrangements become resistant to reform because of high sunk costs, reduced co-ordination and transaction costs, and ingrained popular expectations. Still, domestic reform is guided by far more than path-dependency. Innovation occurs when the incentives for change are strong. In the face of accumulated anomalies and policy failures, policy makers are likely to become convinced that they need to innovate.

If we really wish to understand the dynamics of welfare reform, we need to identify the cognitive and normative orientations of policy actors (Scharpf, 1997b). Policy making is the outcome of *puzzling*—diagnosing the nature and magnitude of the problems at hand, setting priorities and identifying potentially effective solutions—and of *powering*—organising the political and societal support for the selection of particular solutions (Hecló, 1974). Policy reform is not merely 'a contest for power' but depends also on 'playing with ideas', the extent to which policy actors agree over the cognitive definition of policy problems, and the normative benchmarks for effective policy solutions. Governments may be capable of welfare adjustment through policy learning, which is the 'deliberate attempt to adjust the goals or techniques of policy' in the light

of the consequences of past policy and new information so as to better attain effective and legitimate policy solutions (Hall, 1993).

Crises often trigger policy learning. They force policy-makers to evaluate existing policy and to consider alternatives. At such critical junctures, the authoritative nature of politics – also in multi-actor political systems – offers strategic opportunities for policy changes (Wood, 2001).

The recessions of the mid 1970s served as triggering devices, discrediting many left-of-centre coalitions and paving the way for conservative governments, restrictive policies of fiscal consolidation, privatisation, and welfare retrenchment (Pierson, 2001). Policy mistakes can energise the policy process by allowing political decision-makers to overcome institutional rigidities. The cathartic experience of the “Dutch disease” in the early 1980s is a good example of how policy mistakes generate positive learning effects: After a lengthy and painful period of immobilism, a process of self-correction in the Netherlands spurred a remarkable economic recovery without sacrificing core welfare goals. In 1986, the Irish government and social partners prepared their first central agreement for economic recovery, when the Irish economy was said to have reached its nadir. Italy’s political and economic crisis in the early 1990s, which led to a comprehensive redesign of the Italian pension system, was to a large degree fostered by the challenge of EMU. Typically, reforms are preceded by deep political crises, major hikes in unemployment, government deficits, exchange rate pressures, and irresistible economic and political imperatives like EMU participation. Policy failures, however, are not a sufficient condition for policy change. The capacity to translate a crisis into bounded policy innovation depends on political forces and institutional factors.

Besides the political orientations of governments, domestic institutions exert a tremendous influence over the pace of electoral rhythms, the scope, character and style of policy change. They make up the political incentive structure of policy making, determining the degree of influence and power that relevant policy actors can bring to bear on the policy process (Scharpf, 2000a). They shape the structure of political debate, mediate preferences and alter policy choices. At one end of the scale, majoritarian political systems, like in the United Kingdom, give single-party governments the mandate to adopt radical and comprehensive reform. At the other end of the scale, the consensual German and Dutch democracies, based on proportional representation with multi-member constituencies and coalition governments, are more biased towards slow, incremental, disjointed and negotiated patterns of policy change

because of the many veto players that need to be accommodated (Bonoli, 2001). German federal governments are, however, subject to more constitutional limitations than the Dutch. With respect to administrative capacities of policy implementation and delivery, there is also huge variation, ranging from the highly centralized French state to the Italian.

Institutional structures also affect individual policy areas. In some countries industrial relations are fully autonomous from state intervention, as in Germany with its constitutional requirement of *Tarifautonomie*. In others, there is a long tradition of state intervention, as in Belgium and France. In corporatist political economies political authority over industrial relations is 'shared' by the state and the social partners. In Bismarckian social protection systems, there is a strong heritage of associational self-regulation by the social partners. Germany and France share strong elements of union involvement in the management of occupational insurance schemes. This implies that adjustment and reform will require agreement from all parties involved. No matter how weak they might become in terms of union membership strength, unions with this kind of institutional role cannot be easily marginalized, and this will constrain state action (Hemerijck and Schludi, 2000).

Political institutions may limit the repertoire of feasible policy options, but they may also act as a resource, encouraging particular styles of decision-making (Scharpf, 1997b; 2000). Consociational democracies and corporatist systems of industrial relations encourage consensual or problem-solving styles of decision-making, characteristic of Scandinavian and Austrian systems of industrial relations (Swank, 2001). This contrasts the self-interested bargaining style in more fragmented systems, or the confrontational style in statist systems of industrial relations, like the French, with its deeply divided trade union movement and weak employers organisations (Crouch, 1993).

In theory, three directions of policy innovation are possible. One is to preserve the prevailing logic, principles, and institutional format of previous policy. This implies essentially instrumental and incremental change. More daring reforms include changes in the institutional rules of the game and/or changes in the goals and principles of policy. These are best understood, respectively, as institutional adjustment and paradigmatic change (Visser and Hemerijck, 1997). They include new administrative and policy delivery arrangements, new modes of financing, and new roles assigned to public and private actors. When change fails to establish a workable equilibrium, this

often prompts domestic political actors to adopt 'best practices' from elsewhere. In the early 1980s, the Irish followed the British strategy of radical labour market deregulation. After government officials, trade unionists and employers discovered that this strategy was ineffective in countering industrial decline, Irish policy makers shifted to comprehensive social pacts (Hardiman, 2000).

The next three sections highlight recent experiences of bounded policy innovation in different welfare states, in the area of wage bargaining, activation, social services, and, finally, pension reform.

EMU and the wage bargain

The introduction of the Economic and Monetary Union (EMU), incorporated in the Maastricht Treaty (1991), is a major watershed in the process of European integration. EMU, with its independent European Central Bank (ECB), statutorily dedicated to price stability as its primary objective, and the single currency, marks a paradigm shift in macro-economic policy (Dyson and Featherstone, 1999). It is part and parcel of a more general shift to a hard currency policy across the European economies going back to EMS (European Monetary System) of 1979. In important respects, this paradigm shift was triggered by the failure of Keynesian demand policy to the recession-prone 1970s, and to the severe macroeconomic instability in the 1980s and early 1990s.

Monetary integration has consequences for macroeconomic performance and distribution at the level of individual economies, but also for labour markets, social protection, and welfare financing. Both the indirect effects on labour market institutions (Franszese and Hall, 2000) and the direct effects of domestic budgetary and fiscal policy have major implications for welfare state finances. The EMU implies that (Keynesian) macroeconomic policy measures can no longer shield other areas of social policy and economic regulation from the need to adjust to international competition. As nominal exchange rate adjustments are ruled out, adjustment must be sought elsewhere.

Many advocates of EMU argue that its monetary and fiscal rules will spur growth and employment, essentially via two mechanisms. In the first place, a stable macroeconomic framework will result in lower and less variable interest rates, with

beneficial effects on investment and consumption. Secondly, it will also affect the behaviour of the labour market parties by nurturing employment-friendly, decentralised, wage bargaining. In contrast, high debt and deficits would threaten the stability of the Euro and put pressure on the European Central Bank (ECB) to bail out countries in financial distress.

The EMU will also foster low and stable inflationary expectations which, indirectly, will affect wage behaviour, and deficit reduction will create more room for manoeuvre to cope with adverse economic shocks. With the passing of time, as the Euro will gain weight in the world economy, this should result also in lower interest rates world-wide. Many proponents of the EMU, however, argue that its fruits do not come cheap. It will only prove truly advantageous if it is bolstered by structural reforms in the core areas of European welfare states, i.e. in wage bargaining, labour market regulation, social protection and public services.

A more sceptical note is struck by egalitarians who worry that EMU acts as a 'Trojan horse' for a neo-liberal policy shift, undermining the European Social Model (McNamara, 1998). They believe that EMU, given its restrictive mandate, will reinforce low growth and high unemployment, and thus increase pressures on welfare financing. Their remedy lies primarily in more expansionary 'demand-side' policies. Moreover, a unified interest rate is likely to affect countries differently, with the consequence of divergent inflationary and deflationary pressures. Since the ECB can only respond to average conditions, its actual policy may turn out to be either too tight or too loose for particular member states (Scharpf, 2000b). By the same token, there is little scope for macroeconomic adjustment to deal with country-specific or 'asymmetric shocks'. Some even argue that the EMU could undermine Europe's growth potential by triggering a vicious cycle of deflationary 'beggar-thy-neighbour' strategies of internal devaluation through competitive wage moderation. They also fear, finally, that the Stability and Growth Pact is wholly inappropriate to the long-term shifts in public finances related especially to population ageing (Begg et al, 2001).

With the completion of full monetary integration, it is also feared that tax competition will intensify, leading to an under-provision of public goods (Genschel, 2001; Ganghoff, 2000). In order to attract and preserve capital, countries will feel pressed to provide advantageous taxation and/or regulation for internationally mobile firms (Cacheaux, 2000; Steinmo, 1996). Other countries will follow suit, which in the end will cause a lower level of taxation and regulation than was previously found appropriate. Such

developments would jeopardise current systems of social protection (Tanzi, 1998). Following the logic of tax competition, economic integration would result in two significant adjustments in national tax systems (Genschel, 2001):

- a decline in the level of total taxation because the exit-threat of mobile tax bases makes high taxes unsustainable;
- a change in the composition of tax revenues because governments are forced to shift taxation from mobile to immobile bases, such as labour, consumption and real estate.

The empirical evidence, however, suggests that tax competition has so far been limited. Firstly, there has been no decrease in total taxation levels across Europe; to the contrary. Secondly, there is no clear indication of a shift from taxing mobile to immobile factors. Empirical data show that while property and consumption taxes have declined, corporate taxes have gone up.

Some conclude, then, that there is no significant pressure on taxation (Garrett, 1998; Swank, 2001). But this may be misguided. For one, when we consider increasing unemployment, rising poverty, expanding pensions and health care costs, we would have expected that taxation should have risen. Instead, during the 1980s most welfare states turned to deficit spending. If countries were not affected by tax competition, they would not have been forced to seek recourse to deficit financing rather than more taxation in order to finance higher spending requirements. Empirical evidence shows that total tax revenues as well as tax ratios appear to be more or less 'frozen' since the mid-1970s. This suggests that some downward pressure on taxation has indeed been operative. However, there is no evidence that governments have been pushed into a 'race to the bottom'.

The assumption that immobile tax bases are not subject to tax base erosion should also be challenged. Higher taxes on labour increase the labour costs for employers and thus decrease labour demand, especially in an open, competitive economy. What is more, high taxes on labour generate incentives to engage in the black economy. A similar argument can be applied to consumption taxes: consumers will want to buy products without paying taxes and producers will want to sell products without having to remit consumer taxes (Genschel, 2001).

Looking back over the 1990s, we can only conclude that the introduction of EMU has been an immense success. It forced member states to commit to budgetary discipline within the constraints of 3% for the deficit and 60% for the debt (as % of GDP). Following the liberalisation of capital mobility in the early 1990s, the creation of the European Monetary Institute (EMI) to monitor convergence in 1994, and membership qualification in 1998, the Euro was adopted by twelve member countries in January 2002. The UK, Denmark, and Sweden remained outside. Throughout the process, we observe a clear convergence in performance across Europe with respect to inflation, public deficits and government debt ratios. The EMU has inaugurated a more stable economic environment, and to a more closely synchronised EU business cycle. Today, deficit spending is no longer a viable option. In an environment of internationally mobile capital, welfare state reform is high on the agenda so as to lower the burden on the public budget and to dampen the growth of wage costs, irrespective of participation in EMU. Indirectly, the Maastricht criteria, negotiated in 1991 and ratified in 1993, put considerable pressure for budgetary consolidation even on those countries that did not join EMU (Scharpf, 2000a).

Politically, the need to qualify strengthened the relative position of finance ministers and central bankers, at the cost of other actors in the polity. The Maastricht criteria clearly operated as triggering devices, helping to overcome political resistance to unpopular reform. Italy in this respect is exemplar. The Italian welfare state was in effect 'saved by Europe' (Ferrera and Gualmini, 2000).

The resurgence of social pacts

Remarkably, these new constraints have not provided policy makers with a 'window of opportunity' to launch bold strategies of labour market deregulation. To the contrary, EMU seems to have spurred a resurgence of national social pacts aimed at ensuring welfare state sustainability. It is true that in the 1980s there was strong pressure to decentralise collective wage bargaining (Calmfors and Driffil, 1988). The shift to a hard currency has brought the social partners closer together, leading to a remarkable resurgence of social pacts (Fajertag and Pochet, 2000). This process began in the Netherlands with the 1982 'Wassenaar' accord, followed by the 1992 'New Course' agreement and the 'Flexicurity Accord' of 1996. Denmark established more informal norms of wage moderation under the Dmark zone in 1987. Finland followed suit with the 'Stability Pact' of 1991, and later with the 'Social Pacts I' and 'II' in the second half of the 1990s. Similar attempts were made in Belgium in the first half of the 1990s, but these failed until the 1998 'Central Agreement. Similarly, the German 'Alliance for Jobs'

of 1995-6 under Kohl and the 'Alliance for Jobs, Training and Competitiveness' of 1999 under Schroeder, turned out to be fragile agreements. Ireland embarked on a series of tripartite accords in the late 1980s, beginning with the 'National Recovery' accord, which ran between 1987 and 1991, succeeded by the 'Economic and Social Progress' agreement between 1991 and 1994, the 'Competitiveness and Work' accord of 1994, and finally, the 'Partnership 2000' agreement between 1997 and 2000. In Italy, the first pact was the 'National Agreement' on the *scala mobile* in 1992, followed by pension reform in 1995, labour market reform in 1997, and the 'Social Pact for Growth and Employment' of 1998. In Portugal a number of agreements were reached throughout the 1990s (without consent from the largest union), running from the 'Economic and Social Agreement' of 1990, to the 'Short Term Social Concertation Agreement' of 1996, and the 'Strategic Concertation Agreement' of 1997. In Spain important agreements include the 'Toledo Pact' of 1996, and the 'Stability of Employment and Bargaining Pact' of 1997 (Moreno, 2000). Similarly, in Greece a 'Pact of Confidence' was reached in 1997. Especially for hard-currency latecomers, like Italy and Portugal, and Greece, EMU helped to rekindle co-operative, positive-sum solutions (Cameron, 2000; Ferrera and Gualmini, 2000; Rhodes, 2000). Even in Sweden attempts were made to establish a 'Euro' wage norm in 1995, followed by the bipartite agreements in 1997 and the 1998 Pact for Growth. Also Jospin promoted a national social dialogue in 1997 with, however, little success. Except for the United Kingdom, all these social pacts affected wage bargaining systems, strengthening rather than weakening trade unions (Martin and Ross, 2002).

Denmark and the Netherlands have emerged as something of an alternative to neo-liberal deregulation and to traditional 'social democracy' as well, both in terms of institutional and policy change (Benner and Vad, 2000; Visser and Hemerijck 1997). The Dutch strategy of wage restraint has undoubtedly spurred a substantial growth of (mainly part-time) service jobs. This may have had a moderately negative effect on productivity growth due to the large share of low skilled employment involved. Regardless, the Dutch experience suggests a way for other countries, like Germany and France, to boost service employment. To the extent that wage developments in the private and public sector are coupled, wage moderation can lower the public sector wage bill, ease the costs of social security, and broaden the revenue basis (Ebbinghaus and Hassel, 1999). Finally, there is some empirical evidence from Denmark, Ireland and the Netherlands that policy co-operation establishes a smoother interplay between income, monetary, and fiscal policy, thus stimulating economic growth with low inflation.

In short, caught between fiscal strain and the need to address new social risks, significant adjustments are required in order to sustain European welfare states. The resurgence of social pacts and tax reforms in the wake of the EMU indicates the presence of a distinctly European search for a new, economically viable, politically feasible, and socially acceptable option. Some authors maintain that the social pacts will decline in coherence and stability once the goal of EMU-participation is reached, especially considering falling union membership. To counteract this, efforts must be made to initiate bargaining coordination at the EU level (Boeri et al, 2001)

Realigning work and welfare

Contemporary policy fashion emphasises gainful employment as the axial principle of effective citizenship (Clasen, 2000). The new vocabulary of 'employability', 'life long learning', 'activation', 'insertion', 'make work pay', and 'welfare to work', signals a shift in favour of microeconomic supply management (Fay, 1997; Esping-Andersen and Regini, 2000). The new objective is to maximise employment rather than induce labour force exit, and this implies new links between employment policy and social security (Schmidt et al, 1996; Vandenbroucke, 1999).

A main priority everywhere is to up-skill workers through either vocational training or education. If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, they can assume the role of a 'productive factor'.

The consensus over life long learning begins to weaken at the moment one must decide on responsibilities (Crouch et al, 1999). Leaving skill formation to the market may result in under-investment since private firms fear the danger of 'poaching' from competitors. Hence, the inclusion of the social partners may be essential. The key problem, as discussed in Chapter 4, is how to ensure training opportunities for those workers who are most likely to become marginalized, such as those in low skilled jobs, part-time or older workers, and immigrants.

In the 1990s, some countries promoted voucher schemes, tax incentives and Individual Learning Accounts (ILAs) to promote more training. ILAs, like vouchers and co-payments, are based on the principle that: (a) individuals are best placed to choose

what they need to learn and how they want to improve their skills; and (b) that costs should be shared by all the actors involved, employers, workers and government.

Activation

Improvements in vocational training and education are unlikely, by themselves, to solve the problem of skill deficits, particularly for those who have already entered the workforce. Hence, in the 1990s, several governments experimented with various forms of ‘activation’ programmes (Eardley, et al, 1996; Lodemel and Hickey, 2000). The underlying philosophy is one of reciprocal obligations: Welfare recipients must be obliged to accept employment or training in order to receive benefits, while the state has the obligation to enhance the employability of benefit claimants (Clasen, 2000).

The Danish activation policies combine successful employment strategies with an extremely generous benefit system. They have been singled out by the European Commission as a ‘best practice’ for others to follow (Kvist, 2000). While the level of unemployment benefits remained unchanged, restrictions were introduced with respect to duration and eligibility.² In the United Kingdom, by contrast, the emphasis on training and skill enhancement remains limited and is accompanied by less generous income support than is the case in the Denmark (Clasen, 2001). The direct involvement of the social partners in activation is part and parcel of the Danish success story.

Employment subsidies

Demand for low skilled workers can also be raised by subsidies. The U.S., Ireland, and the United Kingdom have followed this approach by extending work-conditional benefits, while other countries have favoured a reduction in social security contributions (France, Belgium, Germany, the Netherlands, Spain and Portugal) (Cantillon and De Lathouwer, 2001). As a result, the number of subsidised jobs has grown dramatically.

Different wage subsidy strategies are appropriate to different welfare states. In the United Kingdom, where income guarantees and unemployment benefits are modest, individual tax credits to support low-wage workers and their families are very popular. In Continental Europe, the main problem is that heavy social contributions price less productive workers out of the market. Hence, reducing fixed labour costs is one way to

² See Chapter 2, and Kvist (2000) for details.

stimulate jobs. Targeted wage subsidies are seen as a means to spur job growth without, at the same time, accepting American style inequalities. Wage subsidies are far less important in countries such as Denmark, in part because public employment is massive; in part because basic income support is generous.

Employment subsidies are not without problems. The British experience reveals that poverty risks for those outside employment have been aggravated by tax credits (Clasen, 2001). Moreover, subsidies may simply permit employers to lower wages rate without necessarily creating new jobs. Since many Continental programs are targeted to the long-term unemployed, they may spur employers to substitute long-term unemployed for short-term unemployed, or to delay hiring until the subsidy can be collected. Also, a policy of reducing social security contributions could jeopardize employers' incentives to upgrade skills. The danger is that employment subsidies may lock low-skilled workers into persistent low-wage employment: the erstwhile 'inactivity trap' may, in other words, become a 'low-skill trap'.

Labour market de-segmentation

In the 1980s, it was widely believed that full employment could only be achieved by a redistribution of existing jobs. The most popular strategy was compulsory working time reduction. In the 1990s, the policy consensus has moved in favour of voluntary work sharing through the expansion of part-time work.

The new policy environment requires more labour market flexibility in terms of work patterns, wages and working time. This may promote a better use of human resources within firms, but also welfare improvements for workers and their families. An effective employment policy must reconcile flexibility with minimal precariousness. There is no inherent contradiction between these objectives. To the contrary, acceptance of flexible labour markets is enhanced if matched by strong social guarantees.

Labour market de-segmentation implies a relaxation of employment protection for the core workforce combined with increased protection for the peripheral and more precarious labour force. The Netherlands are an example of how labour market de-segmentation prevents marginalisation (Barrell and Genre 1999). With the 1995 flexi-security agreements, the legal position of part-time and temporary workers was strengthened in exchange for a slight liberalization of dismissals among regular, full-time employees.

Even in the very 'insider biased' Southern European labour markets, labour de-segmentation is possible. The Treu reforms in Italy sought to favour part-time and temporary work, and in Spain improved conditions for short-term contract workers were accompanied by reduced dismissal costs for those with permanent contracts. In the UK, the introduction of a statutory minimum wage may also imply labour market de-segmentation.

The reforms discussed above have also triggered a change in governance in the promotion of welfare and employment. This is obvious in the case of Danish activation with its individualised guidance and service provision, because it necessitates new institutional connections between social security and employment policy; between the public and private sector. Three trends are clear: (1) the liberalisation of public employment service systems; (2) the widening scope of co-ordination between social protection and employment provision; and (3) emerging sub-national employment pacts in response to problems associated with regional economic conditions (Regalia, 2001).

The new approach to labour market policy has been accompanied by a major restructuring of public employment services. In a number of countries we witness a liberalisation of the regulations governing private employment agencies and of market mechanisms, such as contracting out arrangements. In some countries, this has gone hand in hand with a regionalisation and, sometimes, tripartisation of institutional responsibilities, so as to include organised interests, especially employers, in job placement organisations (Ferrera, Hemerijck, and Rhodes, 2000).

Another example of institutional change is found in welfare state financing. In France, for example, the bulk of health care and basic income support (the RMI) financing has been shifted from social insurance contributions to general taxation (Palier, 2000). This would serve the double goal of reducing payroll taxes and of increasing the leverage of the state over social policy.

Reconciling work and family life

Strategies of labour market de-segmentation are related to the feminisation of the labour market. As examined in Chapter 3, women now account for the majority of job growth in the European Union but, still, substantial differences in participation rates

and also in the nature of female employment remain (Daly, 2000). Low birth rates indicate severe compatibility problems for women across much of Europe, and in Southern Europe especially. Hence the urgent need for policy change.

As argued in Chapter 3, a first policy priority has to do with childcare, leave arrangements, professional care for the elderly, and the tax treatment of spouses' earnings. More social services like child care, could provide additional employment opportunities, especially for women (Behning and Serrano Pascual, 2001). Yet, it is also clear that the nature and quality of jobs play a key role for working mothers.

In Scandinavia, followed by Belgium and France, the expansion of services to families began in the 1970s in tandem with the rise in female labour supply. It was in large part this policy of 'de-familialization' of caring responsibilities which catalysed the dual-earner norm. In most other European countries, female employment growth has come somewhat later (Sainsbury, 1999). In Southern Europe it is only during the past decade that we see a sharp rise (Saraceno, 1994). The big question is whether such a strategy of 'de-familialisation' is feasible under current economic and social conditions?

Recent policy, especially in the Netherlands, seeks to expand childcare through the organisations where parents are employed. The Netherlands now has the highest rate of firm-provided and privately subsidised day care. While this shows that childcare does not necessarily need to be provided by the government, the problem is that private provision is generally limited to high skilled and full time workers. The ambition of the so-called National Childcare Strategy in the UK, on the other hand, is to establish childcare facilities in every neighbourhood. Workers receiving Working Family Tax Credits (usually low skilled and low paid workers), are credited 70 per cent of their childcare costs. Furthermore, opening hours play a significant role in the accessibility of childcare facilities. In many Continental European countries, day care institutions generally open only during mornings, which severely constrains the possibilities of full-time or even part-time employment.

Parental leave arrangements are of critical importance so as to avoid career interruptions. The duration and generosity of entitlements is obviously key. The Nordic countries combine very generous provision and also provide incentives for fathers to participate. In the UK, parental leave is underdeveloped. Indeed, the Thatcher government sought to remove parental leave for fathers from the scope of the EU Parental Leave Directive of 1984. Progress has, however, been made under New

Labour. The National Action Plan of 1999 contains an extension of Maternity Allowance to those under the lower earnings limit. In the majority of Continental welfare states there are provisions for either fully or partly paid maternal leave, but additional parental leave schemes are not all that generous, leading to low take-up rates.

Job security is of crucial importance to the continuity of female employment. The cumulative wage penalty, caused by interrupted working careers, may discourage continuity in female careers, but may also make it prohibitive to have children for career oriented women. Several countries guarantee the right to return to work, after having cared for young children.

Flexible working hours are often a requirement for family friendly employment, and there is a clear relation between the ratio of part-time jobs and female employment growth. But the ability of part-time employment to harmonize careers with family depends very much on regulation, whether it is recognised as a regular job with basic social insurance participation, and whether it offers possibilities for career mobility.

In Scandinavia, part-time employment has been stagnant and even in decline in recent years. This can be seen as testimony of the highly developed policies for reconciling work and family life; part-time employment is increasingly not *necessary* for working mothers. Especially in the U.K. and the Netherlands, part-time jobs have grown steadily over the past decade and account for a large share of female employment growth. Nonetheless, the regulatory framework remains decisive for whether part-time jobs expand. Their growth in Ireland and the U.K. is in large part the product of labour market deregulation in the 1980s. Here part-time work is mainly a coping strategy among low skilled and low paid female workers. The Netherlands exemplifies a more 'women friendly' approach to part-time employment. The Working Hours Act (2000) gives part-timers an explicit right to equal treatment in all areas negotiated by the social partners, such as wages, basic social security, training and education, subsidised care provision, holiday pay and second tier pensions. As a result, hourly earnings differences between full-time and part-time jobs have narrowed to 7%. Dutch employers essentially recruit part-time workers to obtain organisational flexibility, not as a low-price competition strategy, as is the case in the United Kingdom. Indeed, 69% of all employed Dutch women work part-time, which means that further increases in female employment is most likely to follow the Nordic lead of full-time contracts. In the

Mediterranean countries, the pervasive absence of part-time jobs means that fewer women are employed, and if employed they are mainly on full-time contracts.

Since women are more likely to compromise their careers for family reasons, they risk accumulating fewer pension entitlements than their partners. A policy of labour market de-segmentation requires that pension entitlements be universalised, and also that taxation be gender-neutral. To achieve more universal pension coverage, one step would be to introduce a basic, non-contributory pension. Again following the Scandinavian tradition, some countries have begun to make access to a basic pension easier for part-time and temporary employees.

Pressures for more women friendly policy are no doubt intensifying now that the EU has adopted the 60-percent female employment target for year 2010. The pressures are obviously stronger in the Continental European and Anglo-Saxon welfare states with undeveloped leave and care provision. For these countries, Scandinavia might exemplify a 'best practice'. It should, however, be remembered that the conditions that obtained when, in the 1970s and 1980s, the Nordic countries embarked upon their servicing strategy were quite different. This was a period of full employment, and governments then enjoyed considerably greater financial leeway. With the EMU and with fears of tax competition, major public expenditure increases become far more difficult.

In light of this, Dutch policy may provide an alternative model for others to emulate. In its first phase, Dutch part-time job expansion was based on rather short hours contracts. Soon it became evident that further female employment growth would necessitate not only improved access to childcare but also an upgrading of part-time contracts. From this followed the strategy of encouraging firms (often via subsidies) to provide day care for their employees (OECD, 2001a).

The quest for fair and sustainable pensions

Demographic ageing constitutes one of the most pressing policy problems throughout the advanced welfare states. As examined in Chapter 5, the real challenge lies in how to allocate the *additional* expenditures that inevitably accompany population aging. Clearly, the demographics vary substantially between countries. With very low birth

rates and, simultaneously, high rates of early retirement, the Continental European countries face far greater pressures.

Demographic pressures are compounded by design-characteristics in public pension systems. Except for the Netherlands, all Continental welfare states have mandatory PAYGO systems, financed through social contributions. These systems imply high non-wage labour costs that can have seriously negative consequences for employment at the lower end of the earnings scale (Scharpf, 1997; Schludi, 2001). It is also argued that PAYGO systems yield lower rates of return than do fully funded systems (Hinrichs, 2001). Funded pension systems face far less fiscal strain as a result of population ageing. Whereas PAYGO is based on an inter-generational contract according to which the 'young' finance the pensions of retirees, in funded systems each cohort is in principle responsible for its own welfare in old age. As Myles argues in Chapter 5, relying on funded schemes means that the entire burden of additional future pension spending is allocated to the aged themselves; relying fully on PAYGO schemes means that the entire burden is placed on the 'young'.

A few countries, including Denmark, Sweden, and the Netherlands, combine a general revenue financed, basic pension guarantee with funded pensions. Such a combination would in principle produce a better risk diversification combined with higher rates of return (Manow and Seils, 2000).

Ongoing efforts at pension reform offer, once again, an example of path-dependent policy. As is well-known, no reform project can assume a *tabula rasa*. There are huge sunk costs in whatever system obtains in any country. Hence, an overnight shift from PAYGO to a fully funded system would impose a double financial burden on at least one generation. The upshot is that radical change is unlikely, but not that reform is impossible as long as it remains loyal to prevailing principles and starting conditions.

Policy makers must simultaneously secure sustainability and distributional fairness. In terms of sustainability, reforms in Europe will have to adhere to the fiscal constraint of EMU and the Stability and Growth Pact. In terms of fairness, as argued in Chapter 5, intergenerational equity can be assured with the adoption of a fixed relative position (FRP) benchmark, holding constant the income ratios between the working population and retirees. But if we also aim to ensure intra-generational justice, that is, more equality among retirees, this would be best assured by adding a basic, general revenue

financed retirement guarantee to the system – more or less in line with current Nordic and Dutch practice.

There is almost unanimous agreement that pension system reform must be coupled to employment policy. Sustainable pensions will be difficult to achieve unless we raise employment rates among women and older workers. For some countries this involves a double-bind: high non-wage labour costs depress job growth and, yet, they serve to finance pension schemes. It is additionally clear that a reduction of public debt by the time that huge cohorts enter into retirement, around year 2030 in most cases, is vital in order to create greater financial leeway for anticipated spending increases. And, finally, there is a broadly recognized need to match old-age security with more flexibility and 'active ageing'.

If governments were able to bring down the national debt over the next twenty years, so would interest payments and this would, at once, enhance financial sustainability and release funds to meet the needs of an ageing population. In the 1990s, a number of countries, notably the Netherlands, France, Portugal, Ireland, and Belgium, have started to build up pension reserve funds in order to maintain adequate pension provision when the baby-boom generation retires.

A variety of measures have been adopted in order to strengthen the actuarial link between contributions and benefits. These include incremental adjustments in the retirement age, replacement rates and indexation systems. A dominant feature in current reform is to raise contribution rates, which has been done in Denmark, Finland, Greece, Germany and the Netherlands. These measures, when simply applied 'across the board', like in Denmark, usually disadvantage lower income earners. At the same time some countries, like Germany and the Netherlands, have established ceilings to contribution rates that are linked to commitments not to reduce replacement rates.

Raising the retirement age means increasing contributions and reducing benefit payments over a citizen's life span. Under pressure from EU equality legislation, most countries are in the process of equalising the legal retirement age of men and women. Increasing the number of years used to define the reference earnings usually leads to reductions in benefit levels. In Finland for example, pension benefits are now calculated on the basis of the last ten (instead of 4) years; in Italy, the reference period has been extended to the entire career.

Changes in indexation rules for pensions are now common, and also these help reduce pension liabilities. In Sweden, for example, a new proviso states that if pension liabilities exceed assets, then pension indexation will automatically fall behind the income index until the balance between assets and liabilities has been restored. Austria and Germany have moved from gross to net wage indexation, while France and Italy have shifted from wage to price indexing. By and large, these reforms are justified by the argument that the primary purpose of pensions is to preserve the purchasing power of retirees and not to compensate them for productivity improvements.

In Southern Europe, such restrictions have gone hand-in-hand with attempts to upgrade minimum pension benefits. This, of course, ensures greater intra-generational equality and helps create trade union consensus, as evidenced in the Spanish ‘Toledo Pact’ (Moreno, 2000). Italy provides another example. Here, high income earners were subject to indexation adjustments and also an extension of the reference period for full pension earnings, while the minimum pension was raised.

Ground-breaking pension reforms can not be ruled out. Here Britain offers an example. The Conservative governments of the 1980s succeeded in privatizing old age social security by giving employers and the middle classes the incentive to ‘opt out’ of the public SERPS system and contract private occupational pension insurance. One consequence was a marked decline in public pension liabilities, but this has been accompanied by substantial increases in poverty and inequality among the aged. To diminish such inequalities, the Blair government has, in 1999, introduced a “Stakeholder Pension”, aimed at providing pensions for people with insecure employment. In the long run, this basic income guarantee should increase in line with earnings to allow pensioners to benefit from rising prosperity of the country as a whole.

Both Italy’s and Sweden’s reforms move in the direction of a defined-contribution pension scheme. This means that the costs associated with demographic change will fall more on future retirees than on current contributors. These are far-reaching reforms, but their implementation is very incremental, allowing for a long transition period which enables younger cohorts to anticipate a decline in prospective pension benefits by building up supplementary private pension entitlements. Radical, though incremental, changes like these are more viable if accompanied by incentives to take up supplementary (private) pension schemes.

In Italy the transition towards a contribution defined pension system was enacted and implemented in two steps. In the 1992, the Amato government extended the number of contributory years, raised the retirement age, and lengthened the period determining the reference salary for pension calculations. In 1995, the Dini government went still further, introducing a form of capitalisation through the creation of individual retirement accounts. This reform was made possible by support from the unions. Also in this case, the reform is based on a long transition period.

With respect to increased pre-funding, there has been little progress in most Continental welfare states. Germany has gone furthest with reforms to encourage private occupational pensions, and in many countries private plans now enjoy favourable tax status. Since tax deductions favour higher incomes, German policy makers plan to support low-income earner plans with state subsidies.

Interrupted careers cause a disproportional gap in acquired pension rights. Countries like Austria, Belgium, France and Germany now add contribution years to the insurance records of parents who raise children. In the Netherlands, part-time and temporary workers are granted access to basic pension and health care entitlements.

Policy makers now advocate 'active ageing' as an alternative to early retirement. The idea is to keep older people in the work force by measures that make it possible to combine work and retirement. In Finland, part-time retirement was already introduced in the late 1980s. Tax allowances for older workers who remain employed and for those working part-time, as introduced in Denmark, can also enhance the choice-menu among older workers. In Belgium older employees can reduce working hours progressively until they reach retirement age in exchange for a partial pension. And in the Netherlands a supplementary tax credit will be introduced to keep older workers employed. Still, most welfare states have abstained from more proactive policies to raise the employability of older workers and to counter widespread age discrimination of employers.

The degree of success of reform efforts varies considerably, even among countries with similar pension systems (Hinrichs, 2001). The political feasibility of reform depends to large degree on the institutional capacities to orchestrate a consensus among major political parties and/or between the government and the social partners, especially the trade unions (Schludi, 2001). Ground-breaking reforms (except in the a-typical Westminster model), are almost impossible to achieve without broad partisan support.

In Sweden, reform began with a broad political consensus between the social democrats and the bourgeois parties and was subsequently extended to the social partners. In Italy, support from the trade unions was a *sine qua non* for the shift to defined-contribution system. More recently, in Germany, the Schroeder government sought in vain to gain support from the Christian Democrats. The government did finally gain the approval of the Bundesrat, as not only the SPD-led Laender, but also Berlin and Brandenburg, supported the reform. The other CDU Laender still refused (Schludi, 2001). Ex negativo, the absence of co-operation among mainstream French parties and the social partners is an important cause for the lack of progress in pension reform (Palier, 2000; Levy, 2000).

In Southern Europe reform initiatives were part and parcel of encompassing 'package-deals' in the run-up to the EMU, covering wider areas of social protection over which the trade unions have an important say. This was the case in the Spanish Toledo Pact, and also in Italy, where on the basis of trade union consent cuts in pension benefits for the 'better off' were 'traded' for improvements among the lower income earners. Through such issue-linkages, governments in Italy, Spain and also Portugal managed to obtain union support to make substantial changes in their pension systems. The social partners, especially the trade unions, were apparently able to internalise the trade-off between increasing pension demands and the fact that those pensions need to be financed out of contributions from the working age population (Myles and Pierson, 2001). Using such methods of 'positive co-ordination' on the basis of a common agreement on overarching policy goals, the scope for effective policy reform increases dramatically (Hemerijck and Schludi, 2000).

All told, with the exception of Scandinavia, there has in reality been little progress to encourage employment among older workers. Guillemard's (1999) appraisal of the lack of substantial reforms in France applies basically to all Continental welfare states: The aging debate tends to focus on pensions. Proposals for delaying the retirement age by simply increasing the number of contribution years required for a full pension provide insufficient incentives to continue working. Extending working life longer calls for an active employment policy.

6.4 DEEPENING SOCIAL EUROPE THROUGH OPEN CO-ORDINATION

In the European Union we observe some convergence of employment and social policy objectives over the past decade. All member states are explicitly dedicated to raise

employment, promote social inclusion, invest in the productivity and skills of future workers, and enhance innovation in the pursuit of a competitive knowledge-based economy. The Treaty of the European Union (Title XI, article 136) already lists a number of common social policy ambitions, ranging from ‘the promotion of high levels of employment, the raising of the standard of living and working conditions, adequate social protection, the social dialogue, the development of human capital and the fight against social exclusion’. This convergence in objectives and ambitions not only reflects shared aspirations, but perhaps more precipitously a common concern with the new risks of social polarisation.

If Europe’s social concerns are not merely symbolic, then we face the question of a possible common European welfare strategy. Economic integration has made it easier for citizens and corporations to opt out of national social insurance schemes. By the same token, European citizens increasingly fear a race-to-the-bottom, involving tax competition and/or social dumping between rival economies. Accelerated economic integration without any meaningful social progress could confront the European Union with severe legitimacy problems.

For three reasons a fully-fledged European welfare system in the near future is rather unlikely to emerge. For one, the room for a European Union employment and social policy is already occupied by strongly entrenched national policy (Leibfried and Pierson, 1996; 2000). Secondly, national policy makers are generally unwilling to transfer social and labour market policy competencies to EU institutions. Thirdly, it may very well be that member states face broadly similar challenges, but ‘the devil lies in the detail’. In this case, the detail encompasses not only policy legacies but also substantial institutional diversity.

The principal site for welfare reform remains the nation-state and, yet, domestic reforms are severely constrained by the EMU and increasingly shaped by supranational regulation and policy initiatives. While domestic policy makers are wary of surrendering any authority, there is nonetheless a case to be made for greater co-ordination at the EU-level. In a period of growing international interdependence, the performance of one national economy will hinge ever more on the performance of other member states. As governments search for solutions to pressing policy problems, they may first turn to their own past experience. However, in the face of increased uncertainty, policy makers can hardly be expected to effectively build on their own past policy experience to come up with new answers.

From Rome to Laken

The formative period of the European Union, culminating with the Treaty of Rome in 1957, included only six countries and there was an implicit assumption that social policy harmonisation would evolve naturally. With each wave of enlargement the barriers to harmonisation obviously rose. Indeed, the harmonization of employment and social policy eventually became an important impediment to economic and monetary integration. In the 1980s, European integration was biased in favour of 'market-building', of eliminating trade restrictions and competitive distortions. The Single European Act (1986) strengthened the legal basis of the Commission by extending qualified majority voting on issues of the internal market. Countervailing initiatives of 'market correction' in the area of common employment and social policy remained subject to unanimous consent. This clearly inhibited ambitious European-wide employment and social policy initiatives (Scharpf, 1997a; 1999; Streeck, 1992). Notwithstanding the dominance of 'negative integration', the Delors commission managed to become more active in the area of social policy once the Single European Act was ratified in 1987. In 1989 several directives and recommendations were put together under the 'Charter of Fundamental Rights', to be incorporated into the Maastricht Treaty. However, due to the veto of the Thatcher government, a 'social chapter' in the Treaty of the European Union was ruled out (Lange, 1993). As a result, EU-wide employment and social policy initiatives were largely absent from the completion of the Single Market and the introduction of EMU. But this began to change with the Dutch Presidency in 1997.

A first real breakthrough was the insertion of an Employment Chapter in the Amsterdam Treaty (1997). At the European Council of Essen in December 1994, European leaders adopted a medium-term strategy for the fight against unemployment (Goetschy, 1999). Five priority objectives were identified: investment in vocational training and life-long learning, increasing the employment intensity of economic growth through flexible employment and wage restraint, reduction in non-wage labour costs, improvement in active labour market policies and targeted measures to help the long-term unemployed. In terms of institutional procedures, the Essen Council proposed annual evaluation procedures in order to monitor progress. The European Summit in Dublin (1996) sought to add an employment chapter to the revised treaty, and a High-Level Employment and Labour Market Committee was established with

this aim in mind. This was the precursor to the Amsterdam Treaty which officially raised employment to the status of a common European concern (Larsson, 1998).

The employment chapter stipulates that member states participate in policy coordination around a common strategy defined by the Council. The chapter does not confer competencies to the EU to interfere in domestic labour markets. Institutionally, the employment chapter formally assigns a public status to the social partners in the process, both at the level of the EU in formulating guidelines and at the level of individual nation-states with respect to the drafting of national action plans (NAPs).

Agreement over the employment title was helped along by the rise to power of Centre-Left governments in the EU, in particular in large countries, like France, Italy, the UK, and Germany, which triggered a search for a new European approach to employment and social policy. After the victory of New Labour in the British general election of May 1997, Blair instantly put his support behind the European employment strategy. Shortly after, France also endorsed the employment strategy. Meanwhile, social unrest in Belgium, Germany, Italy, and France in 1995-1997 added to the fear of competitive social dumping.

In 1998, the European Employment Strategy (EES) was formalised and Member States, with the involvement of employer organizations and trade unions, were required to report on its implementation. On the basis of the annual evaluation, the Council was allowed to issue recommendations to individual member states to revise their policies. Such advice, however, does not carry the penalty of sanctions (Porte, Pochet and Room, 2001). Its sanctioning power lies entirely in 'peer pressure'.

Contrary to what sceptics might have feared, first results reveal progress. Institutionally, the EES has helped extend social partnership involvement in the guidelines. Also, the Joint Employment Reports signal a reorientation of national policies from passive to active measures. Moreover, the new 1999 guidelines on gender mainstreaming, including policies on career breaks, parental leave and part-time work, reveal new priorities in favour of reconciling work and family life (Bercusson, 2000). Another ground-breaking change is the requirement to introduce policies to keep older workers in the workforce. In 2001, numerical targets for increasing participation rates were established.

Following the second evaluation exercise of the NAPs, the Council identified eight areas where national implementation remained insufficient: youth unemployment; preventing long term unemployment; tax and unemployment benefit reforms; job creation in services; modernisation of work organisation; making taxes more employment friendly; the fight against gender inequalities; and improving statistical indicators.

Progress in terms of European social protection also emerged in the second half of the 1990s (Falkner, 1998). Here, too, development flowed from the notion of a 'convergence of objectives' rather than 'harmonization'. The Commission presented in 1999 its proposal for "A Concerted Strategy for Modernising Social Protection", a framework for closer co-operation in social protection, again based on annual reporting with a view to identifying best practices (European Commission, 1993; 1997; 2000d).

The Lisbon Summit marked a watershed in the Europeanisation of employment and social policy. It produced concrete commitments to increase the rate of total employment in the European Union to 70% (60% for women) by 2010, the promotion of lifelong learning, and increased employment in services. With respect to social protection, it launched the open method of co-ordination to new policy initiatives for fighting poverty, combating social exclusion, and modernising systems of social protection. The Portuguese presidency agreed to draw up European guidelines for social protection, which would be implemented in the same manner as the Employment Guidelines; setting common objectives that are ambitious and realistic, using clear indicators whenever possible; ensuring necessary flexibility for member states to implement policy, and fostering co-operation among member states (European Commission, 2000b). More recently, the Swedish Presidency proposed to apply the method of open co-ordination to health, elderly care, and to pensions (European Commission, 2000e; European Council, 2001). It also included targets to raise employment among workers aged 55 to 64 to 50% by 2010. The Belgian Presidency in 2001 forged a political agreement on quantitative indicators for monitoring progress with respect to social inclusion across member states. It also sponsored, at the Laken Council in December 2001, common objectives for pension reform. The fight against unemployment and social exclusion has thus become part of the EU constitution.

Strengths and weaknesses of open method of co-ordination

With fifteen different welfare states, not to forget a possible enlargement with ten candidate countries, there obviously does not exist any single "European social model"

towards which member states of the European Union could possibly converge in the next decades (Ferrera, Hemerijck and Rhodes, 2000). Clearly, the issue is not one of subordinating domestic policy to EU directives but rather one of joint policy learning and co-operation.

The European Employment Strategy inaugurated a new model of cross-national policy making through monitoring and benchmarking, and the Open Method of Co-ordination (OMC) launched a new mode of European governance. The latter promotes a 'learning-friendly' environment for policy innovation and experimentation while recognizing that national welfare states are profoundly different. This is a major breakthrough in an environment which, for long, remained paralysed by resistance to supranational harmonisation and fears of a race to the bottom.

OMC is a procedure whereby domestic policy actors respect national differences while accepting commonly agreed guidelines and taking inspiration from 'best practices' abroad. The objective is not to achieve common policies, but rather to share policy experiences and practices. The conclusions of the Lisbon Summit list a number of key elements of OMC:

- setting short, medium, and long term guidelines for the EU with specific timetable for their achievement;
- establishing performance indicators and benchmarks tailored to each member state to allow comparison of best practice;
- translating targets from European guidelines to national policy responses;
- periodic monitoring, evaluation and peer review and evaluation with an emphasis placed on mutual learning processes.

Open co-ordination should be located somewhere between the modes of "intergovernmental negotiations" and "mutual adjustment" (Scharpf, 2000b). Government competencies remain entirely national but are no longer pursued in isolation.

As an iterative process, OMC provides ample opportunities to tackle employment and social problems in a medium-term perspective. It helps de-politicize the issues at stake, and it encourages a problem-solving style of policy making. Moreover, it facilitates policy in areas where EU competencies are relatively weak, where regulation is infeasible and impracticable. The experience with EES reveals that member states seem

to be more willing to accept initiatives of Community action when the EU does not have legally binding powers.

Contextualised benchmarking

Benchmarking and monitoring are central to OMC. Benchmarking requires (a) collection of data on policies and their outcomes ; (b) assessment of the outcomes and of how policies affect such; and (c) some determination about whether the institutional environment surrounding the policy is comparable (Romanelli, 1999).

OMC exemplifies a 'contextualised' method of benchmarking, allowing consultation over guidelines and national action plans, with ongoing feedback on implementation (Hemerijck and Visser, 2001). Most often, a 'decontextualised' benchmarking prevails, leading to the promotion of one exemplary case for others to follow. A quote from the Joint Employment Report 1999 is instructive in this respect: "The essence of this method is an examination of the transferability of a policy presented by a 'host country' by several interested 'peer countries'. The core activity in each peer review is a seminar complemented with a site visit. It is a structured activity based on a number of expert papers prepared in advance specifically for this exercise" (European Commission, 2000b)

Benchmarking and monitoring offers the possibility of acquiring information through standardised evaluations. Relying on elaborate guidelines, targets, deadlines and evaluations, the strategy is pragmatic in dealing with national contingencies and vulnerabilities. The exposure to others through peer review is a useful motivator because no government wants to be seen to perform badly. More important is the experience gained through peer review. The OMC stimulates an understanding of national contexts, whereby policy makers are able to assess why some solutions can or cannot be transposed to their own national context.

Taking learning seriously highlights the importance of ascertaining the possible *and* a willingness to experiment. Open coordination combines two types of policy learning: *learning from others*, with a large element of 'lesson drawing' and mimicking based on the experience in other countries; and *learning with others*, or 'interactive learning', based on joint processing and exchange of information and experience. OMC can potentially stimulate '*learning ahead of failure*' (Hemerijck and Visser, 2001). It may expand the repertoire of policy responses, and learning from success elsewhere, policy

makers may reduce the costs of pure trial and error. In this sense, the open method of co-ordination marks a step towards a *preventive* labour market policy.

Shortfalls of OMC

Some fear that 'soft' policy co-ordination, with its lack of real sanctions, will crowd out 'hard' legislation. Domestic policy innovation can easily be masked by repackaging existing policies. Moreover, rushing towards social benchmarking with reference to vague objectives runs the risk of discrediting the entire process. In the absence of sanctions or rewards, the attempt to co-ordinate social objectives may prove futile.

In short, OMC is no panacea and will possibly need to be accompanied with legislation. To be sure, health and safety at work and regulation of second pillar pensions requires legislation. OMC is especially useful in policy areas where EU competencies are constrained and where policy objectives are ambitious. One of the most sensitive issues, especially in the areas of social protection, is the quality and quantity of available statistics on performance. Additionally, a key political question is how and to what extent feedback from learning processes contribute to the improvement of guidelines. The Europeanisation of employment and social policy cannot affect the balance of political power in individual member states. A change in national governments may, for example, alter nations' policy priorities. A final concern is how much diversity in welfare design, institutional structure, and problem loads that OMC can tolerate. This issue may become acute with the impending accession of many Central and Eastern European countries.

Open co-ordination has the potential to develop into a valuable addition to the modes of governing now available in the European polity. Open co-ordination is imminently more flexible than 'joint decision procedures' or 'inter-governmental negotiations'. Moreover, in contrast to 'mutual adjustment, it can provide useful safeguards against an unintended 'race to the bottom' (Scharpf, 2000b). Policies may even converge in a voluntary process of multi-level diffusion as the experience with new policies accumulates. The OMC does, however, remain fragile, in the sense that it is highly contingent on the extent to which national policy makers see themselves as pursuing convergent or parallel goals. Nevertheless, successes achieved through OMC are likely to enhance the legitimacy of the EU as a social union.

Conclusion

Domestic welfare reform throughout the 1990s mark distinctive, and sometimes successful, responses to the massive policy challenges ahead, and we would expect the momentum to continue. In contrast to the view of Europe as 'sclerotic', this chapter has highlighted a dynamic and distinctly "European" type of reform process. It is a process that continues to adhere to deep-seated commitments to equity and solidarity, to the belief that social protection enhances efficiency, and to institutional preferences for negotiated rather than imposed change.

The self-transformation of the European social model has never been guided by some grand master plan, from which policy then ensued. The European reform model is replete with contingencies, policy failures, co-ordination and implementation problems and, obviously, shifts in the balance of political and economic power.

The 'trial and error' nature of European social reform means that attempts to solve problems in one particular policy area may, through a dynamic of spill-over effects, create problems in neighbouring policy areas. New problems trigger yet another search for new solutions, both horizontally (across policy areas) and vertically (between different layers of governance). Since the mid-1970s, macroeconomic instability stimulated a learning process through which the hard currency EMU was established. The imperatives of monetary integration put pressure on systems of industrial relations, leading to new adaptations in wage bargaining. New bargaining procedures, in turn, encouraged a search for more active labour market policies, as well as 'activating' social security provisions. And with the rise of services and female employment occurred a reorientation of policy. Last but not least, steps are being taken to make pension systems fair and sustainable in the face of population ageing. Politically, most of these sequential stages of bounded policy innovation were outcomes of lengthy processes of (re-)negotiation between political parties, governments and often also the social partners.

Policy innovation at the national level has shaped the employment and social policy agenda of the European Union. Persistently high unemployment in the run-up to the EMU raised the urgency of a common European strategy. In the second half of the 1990s, aided by the presence of centre-left governments, we see a deepening of Social Europe. The success of the European Employment Strategy provided a window of opportunity for European employment and social policy which, in turn, catapulted the open method of co-ordination. OMC may very well unleash a process of 'hybridisation'

in welfare and labour market policy. This could lead to new policy mixes, something which is already apparent in small countries like Denmark, Ireland, the Netherlands, and Portugal. Welfare reform in the first decade of the 21st century will increasingly involve a combination of *domestic learning*, *learning from and with others*, and hopefully also a learning *ahead of failure*.