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Policy Adjustment under International Constraints :
Sequences of Challenges and Responses

Anton Hemerijck and Martin Schludi

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Contact information:
Martin Schludi
Max-Planck-Institut fuer Gesellschaftsforschung
Paulstr. 3
50676 Koeln
schludi@mpi-fg-koeln.mpg.de
Tel. +49(0)221/2767-244
Fax +49(0)221/2767-555

1 Introduction

Since the early 1970s, the scope for national social and economic policy in advanced industrial societies has been constrained by three consecutive changes in the international political economy. These were: 1) the breakdown of the Bretton Woods currency regime of fixed exchange rates and the first oil price shock of 1973, resulting in the policy dilemma of stagflation; 2) the emergence of a rather restrictive international economic environment, with very high real interest rates, in the wake of the second oil crisis of 1979; leading to a massive surge in unemployment in the majority of OECD countries, and, finally, 3) the further liberalization of capital markets since the mid-1980s, and the creation of a single European market with a single currency. Fritz Scharpf has identified how the three cumulative changes in the international policy environment have over the past three decades come to undermine the prevailing growth and full employment oriented policy strategies that were still viable towards the end of what Jean Fourastié called *les trentes glorieuses* (1945-1975). The focus on this chapter is on the impact of the three challenges in the external economic environment on the advanced

welfare states on social and economic policy adjustment pursued in the twelve countries in our sample.

From the late 1970s onwards, it became increasingly difficult for the national welfare states to deliver on its core commitments of full employment, social protection, and equality. Moreover, the failure to alleviate the destructive impacts of the multifold recessions of the 1970s and 1980s brought on a distinct shift in the political balance of power from the political left to right, unleashing various conservative attacks on the welfare state in many advanced political economies. In the second half of the 1980s and the early 1990s, while some of the earlier constraints of high oil prices and high real interest rates were lifted, they were replaced by novel ones, resulting from the liberalization of capital markets and the EMU convergence criteria, with similar implications for policy, engendering a politics of *permanent austerity* for the majority of the countries in our study (Pierson, 1998).

The purpose of this chapter is to analyze and compare the delicate and lengthy political processes of policy change in different welfare states. We will particularly highlight the significance of 'sequencing' in country-specific patterns of policy responses to the challenges brought on by economic internationalization (Thelen, 1998). While the three challenges play a prominent role in the politics of adjustment and welfare reform, the intensification of international economic constraints, however severe, does not seem to have resulted in a corresponding narrowing of the scope for policy choices in different countries, at least not at the same time or to the same extent. Alongside the changing international economic environment, all the advanced welfare states have been confronted by a number of interrelated endogenous economic, demographic and social changes, ranging from the rise of the service sector; the maturation of social policy commitments; the demographic predicament of ageing populations; to changing household patterns and their consequences for the organization of paid and unpaid work in society. On balance, Paul Pierson maintains that the condition of 'permanent austerity' within which the welfare state finds itself today, probably has more to do with these endogenous structural changes than with increased international economic integration. Although we welcome Pierson's qualification to the globalization literature, we would like to warn against the temptation to engage in an 'either-or' type of debate. For most

countries exogenous economic and domestic post-industrial pressures work in tandem. The reason why we approach the comparative analysis of policy adjustment from the angle of the international political economy is not only substantive, but also methodological. Because the three international economic challenges confronted the advanced welfare state in a set chronological order, this allows for a good comparative charting of sequential patterns of policy adjustment. Our approach also enables us to focus on how in different countries external economic challenges have come to spillover into domestic political conflict, providing different political actors with windows of opportunity for changing social and economic policy. Policy adjustment is a political process. To be sure, the recession in the late 1970s in many countries served as 'triggering device', discrediting many left-of-center coalitions, providing conservative governments, after important electoral victories, with clear political mandates for restrictive economic policy choices, deregulation, liberalization, privatization, the dismantling of the welfare state.

The principal lesson learned from the country studies written for this project is that, even within the tunnel of the step-wise narrowing of international economic constraints, there remains considerable scope for autonomous social and economic policy choices. This becomes all the more evident when we draw together a wider range of policy areas in the comparative analysis of processes of policy adjustment than the ones which are generally thought of as relevant in comparative welfare state studies, which rather singularly tended to concentrate on areas of retrenchment and/or re- or decommodification (Esping-Andersen, 1996; Pierson, 1994; 1996). We thus propose a broader conception of the welfare state, embracing the policy areas of macroeconomic policy, industrial policy, wage policy, tax policy, social security policy, and labor market policy and regulation. In order to understand welfare state change we believe it is crucial to understand the linkages, interdependencies, and dynamic interaction effects between different policy areas across time in the face of cumulative external challenges. Welfare retrenchment cannot be studied in isolation of policy choices made in macroeconomic regulation, wage bargaining and labor market policy and regulation.

In the 1970s, some countries, like Austria and Sweden, were rather successful in withering the crisis of stagflation, while others, like the United Kingdom and Italy, were

unable to contain spiraling inflation and a massive surge in unemployment. In the wake of the second oil crisis, which hit Belgium and the Netherlands particularly hard, only the Netherlands proved able to change macro-economic and social policy priorities in line with the new requirements of the international political economy. After the liberalization of capital markets in the second half of the 1980s, Denmark and the Netherlands were successful in creating (or maintaining high levels of) employment, while defending their core commitment to social justice. Other countries, among which France, Belgium, and Italy ran into severe financial difficulties. The same holds true for Sweden, which in the face of a domestic boom, the swift liberalization of capital markets, and the international economic consequences of German unification, had to give up – overnight - its growth oriented macroeconomic policy strategy, which had served Swedes so well in response to the first and second oil price shocks. Towards the closing of the twentieth century we observe an reversal of the fate of center-left parties, which suffered so badly in the wake of the 1970s recessions. After the fight against inflation was won by deflationary policies, principally by conservative government, the problem of mass unemployment continues to loom large, especially in Europe, with an average unemployment rate of eleven percent. Many center-left governments currently in power in the majority of member states in the European Union now embrace the anti-inflationary consensus, embodied in the Maastricht Treaty. But in the face of low levels of inflation and the prospect of jobless growth, unemployment has again become the focus of political concern and attention. European electorates, probably tired of welfare retrenchment, seem to have regained faith in the Left of center governments to manage the economy in line with a commitment to social justice.

These experiences go against the often implicit assumption in much of the globalization literature that increased international competition in product and capital markets undermines the autonomy national welfare states to pursue independent employment and social policies (Kurzer, 1993). There is even some evidence that a loss in external room for maneuver in the area of macroeconomic policy generates an increase in policy creativity and energy in other areas of social and economic regulation. But it is a mistake to believe that each country could have done equally well in responding to the challenges of the 1970s, 1980s, and 1990s. As Fritz Scharpf has already shown, countries differ in the degree of international economic vulnerability, which relates to the

levels of economic openness, production profile, relative dependence of raw material resources, and relative wealth. Above and beyond economic vulnerability to international competition and interdependence and endogenous structural changes, the twelve advanced welfare states in our sample entered the era of economic internationalization with very different social and economic policy repertoires. As a consequence of these different, relatively stable, 'start up' constellations, different welfare states have pursued divergent policy strategies of adjustment. The various international shocks and challenges somehow disturbed the different postwar equilibria, and some countries suffered worse than others, and some have had to or were able to transform their Golden Age policy profiles more than others. In short, the end of the Golden Age was the beginning of a period renegotiating the social contract upon which the welfare state was built. All the advanced welfare states in the OECD-area have, over the last quarter of the twentieth century, been recasting, to different degrees, at different times, under different circumstances and with different levels of success, their once stable policy repertoires of social and economic policy. It is appropriate to portray these efforts at recasting of the welfare state as a political *system-wide search* for new, economically viable, politically feasible and socially acceptable repertoires of social and employment policies. In this chapter we examine why different welfare states responded the way they did to the international economic challenges of the 1970s, 1980s, and 1990s, and how and to what extent, over time, they have come to reconfigure their policy profiles of social and economic regulation. We will particularly highlight issues of timing, learning and interaction effects between choices made in different social and economic policy areas at different moments in time. We will show how the policy changes in the areas of macroeconomic policy, wage bargaining, welfare policy, and labor market policy, are 'sequentially' related. It is our contention that, over time, consecutive policy responses pursued in different policy areas created the conditions and the demand for subsequent policy changes in other areas of social and economic regulation.

Moreover, given the high degree of uncertainty, ambiguity and controversy that surrounded the process of economic internationalization over the past decades, policy makers in different countries often opted for policy responses, which they believed were highly appropriate at the time, only to discover later on that their strategies were based on

'mistaken' policy diagnoses and projections. To give an example: in the 1960s economists believed that no economy could suffer both from high inflation and high unemployment. The condition of inflation would stimulate economy and unemployment would serve to reduce inflation. After the first oil-price shock, it took time before economists and for policy makers more so to recognize that the problem of stagflation, the combination of high levels of employment and inflation, was both empirically and theoretically likely. If we accept that, under conditions of uncertainty and confusion, policy makers are likely to make mistakes, based on the mistaken, but in retrospect entirely understandable, judgements of policy problems, this means that policy choices, including their policy successes and failures, are likely to vary significantly, not only from country to country, but also over time within the same country. And as policy mistakes engender policy failures, which, in turn, lead to political conflict, which, after a critical election, may result in an overhaul of the existing policy profile, or more incremental negotiated adjustments to solve a political stalemate, or, worse, implicit non-agreement and the continuation of policy immobilism. But things do not stop evolving. Policy immobilism in due course may enable a new generation of policy actors to enact policy changes to break prevailing 'joint-decision traps', depending on the urgency attached to the crisis at hand and the degree of policy discretion of and consensus among the relevant policy actors (Scharpf, 1988).

The aim of this chapter, however, is not merely to elucidate idiosyncratic patterns of policy adjustment of the countries in our sample. We will also try to evaluate the consequences of the policy choices adopted over the past three decades in terms of how successful they have been in stabilizing macro-economic performance, creating employment, while maintaining decent levels of social protection and equality. There is no standard model for evaluating the effectiveness of national policy responses to economic internationalization. Policy effectiveness is a highly contested concept. Indeed, for the period covered in our study, there was little consensus over social and employment policy effectiveness. In the highly politicized debate on the welfare state, critics on the right were quick to argue that the welfare state accumulated a vast array of labor-market rigidities, which undermined any effective strategy of policy adjustment in an increasingly interdependent world economy. From this perspective, the policy recipe was and still is to radically scale down the welfare state. Defenders of the welfare state, by contrast, argued,

as they still do, that social policy ensures that most income groups have reasonable access to income and education, which is good for overall productivity and, as a consequence, beneficial for high quality investment decisions. Needless to say, it remains extremely difficult to objectively measure the potential positive and negative effects of social and employment policy and, especially, to establish the relative weights of the economic costs and benefits of the welfare state in an era of global competition. It is for these reasons that, in measuring policy effectiveness across time, we have decided to hark back to the original 'normative' objectives of the welfare state in terms of the achievement of employment for many and social justice for all, seen from the perspective of the least advantaged in society.

The rest of the chapter is organized into eight sections. In section 2 we present our theoretical perspective on sequential and composite character of the process of social and economic policy adjustment. Changes in the international economy, interaction effects across important policy areas and time, problem-induced learning effects, and efforts at cross-area policy coordination, we argue, shape the pace, scope, and direction, successes and failures, of policy adjustment. In section 3 we introduce the six important policy areas of social and economic regulation that have been directly or indirectly affected by increased international economic interdependence and competition. The policy areas covered are macro-economic policy, industrial policy, wage policy, tax policy, labor market policy and regulation, and social security policy. For each policy area we will highlight a number of important policy changes that have been undertaken over the past twenty-five years. In the sections 4 to 7 we present stylized summary reports of the country-specific historical sequence of interdependent policy shifts in the six policy areas under study, supported by a tabular synopsis of national policy responses as indicated above. We will largely follow the relevant political economy and welfare state literature by distinguishing between the Christian Democratic Continental model, including Germany and its smaller neighbors Austria, Belgium, the Netherlands and Switzerland, the Republican-Mediterranean countries France and Italy, the Social-Democratic Nordic welfare states of Denmark and Sweden, and Liberal Anglo-Saxon countries, Australia, Britain and New Zealand. In our summary assessments, in the final part of this chapter, we provide comparative information on national policy responses across time. For section

8, in conclusion, we allow ourselves to speculate, on the basis of a limited number of successful countries, about the policy options for a economically robust, politically feasible, socially acceptable, fair, equitable and efficient, 'employment friendly' welfare state at the beginning of the twenty-first century.

2 The Sequential Logic of Policy Adjustment

Social and economic policy adjustment is a fundamentally dynamic political process. Increased international economic interdependence impinges on a wide variety of policy areas of social and economic regulation (see below), which, in turn, are likely to trigger political conflict over issues of policy change. We are especially interested in how the three common international challenges of the past three decades have intersected with domestic policy change. The theoretical argument of this chapter on policy responses and their relative effectiveness builds on three propositions. First, trajectories of policy adjustment are paved with interaction effects between policy choices made in different policy areas across time. Second, policy makers tend to respond to international constraints through problem-induced search processes of trial and error, usually by addressing one politically salient policy problem at a time. Third, the extent to which policy interdependencies are the object of explicit policy coordination is critically important in the process of sequential policy adjustment and learning.

2.1 Timing and interaction effects

Patterns of social and economic policy adjustment follow a temporal or sequential-diachronic logic. Timing, interdependencies and interaction effect between different policy areas are fundamental to policy adjustment. Changes in the international political economy are likely to disturbed and upset the 'goodness of fit' among the differentiated policy areas of the welfare state and are likely to 'trigger' political opportunities for policy change. Emerging incongruities within the existing policy profile and the new problem constellation of the international political economy are played out in a sequence of events, which are best studied in terms of spillover effects between policy choices made across

different policy areas. Processes of sectoral spillover can, in turn, be the cause of political mobilization and counter-mobilization in favor or against different policy strategies. In due course, the sequence of events may culminate into a new configuration of social and economy policy that is far removed from the original Golden Age policy profile. To be sure, strong forces of path-dependency are at work in processes of policy adjustment. However, path-dependency arguments are about factors of historical contingency which make it difficult, but not impossible, for policy actors to reverse earlier policy choices.

Since the 1980s, most comparative political economy studies focused on how single international economic shocks, like the first of second oil crisis, acted as catalyst for path-dependent policy change in different political economies, which understood as coherent, well-integrated, self-reinforcing 'models' of welfare capitalism. We depart from this approach in two ways. In our comparative analyses we, first of all, deal with three of such external economic challenges, posing different challenges at different points in time for individual countries. Second, we refute the idea that policy changes in different policy areas, in agreement with Orren Skowronek, are somehow 'synchronized in their operations and synthetic in their effects'. To be sure, different policies are rooted in country-specific institutional legacies, state traditions and cleavage structures. Over time, in some political economies, the various policy areas have become strongly interdependent or 'tightly coupled'. But 'tight coupling' has rarely been a product of grand design, except for perhaps the Swedish model. What matters for our purposes is that because of these policy interdependencies changes in one policy area can have important consequences in others and that the prevalence of policy interdependencies make it impossible to analyze policy change in different countries on the basis of single policy areas.

The effect of policy change in a single policy area can only be understood in its interaction with other policy areas. Studying policy adjustment in terms of a process of sequential spillover across six policy areas in the face of three important changes in the external environment, is likely to bring out very contingent portrayals of policy change. In each country there is distinctive sequence of policy change, fed by political controversies over various policy problems in different areas. Sequencing matters in many different ways. Whether a Left or a Right party or coalition happened to be in power when an external

challenge make itself felt is obviously important, as these governments are faced with the initial task of crisis-management. The interruption of an important international economic challenge to an ongoing process at Time 1 is likely to modify the constraints and opportunities for policy adjustment in a number of relevant policy areas. If ruling government fails to manage the economy, this gives the opposition a powerful opportunity to discredit ruling governments. Critical elections can render an incoming government a strong political mandate to change social and economic policy. However, given the fact that we are dealing with multiple challenges, later disruptions in the international political economy can easily upset the policy strategies adopted by government elected after the earlier crises, which again may spillover into electoral competition. The next round of reform is surely in part determined by policy responses adopted earlier in the sequence of policy adjustment.

We believe that spillover effects between different policy areas holds another important key to understanding how external processes are likely to produce openings for policy change. Cumulative international economic constraints, we argue, impinge on political economies through specific policy areas. Policy adjustments made in designated policy area at Time 2, together with its relative success or failures, subsequently, have important consequences for the content and scope of consecutive reform efforts in other areas of social and economic regulation at Time 3, when policy makers confront novel challenges in the international environment. Potentially, an effective policy response pursued at Time 2 can become severely constrained at Time 3, when changes in world markers interfere and drive the adjustment process and its performance in yet another direction. Policy choices adopted at Time 2, which were congruent to the prevalent problem constellation at the time, may become redundant overnight as a result of a novel external challenge which produces an entirely different problem constellation. By the same token, an ineffective policy response at Time 2, is likely to require and result in more path-breaking policy changes at Time 3, when new constraints intensify crisis-conditions. From this, it follows that whatever initial policy responses countries adopt to tackle the crisis of stagflation in the late 1970s, these may unintentionally create additional problem loads in other policy areas at a later stage. The crisis of stagflation mostly affected macroeconomic policy and wage policy, and provided relevant policy actors with windows of opportunity for

a negotiated incomes policy in many corporatist political economies and for more a radical U-turn in macroeconomic policy in the Westminster systems of the United Kingdom and New Zealand. In the process, policy change in one policy area can have (un)intended consequences for other policy areas. As a consequence of sectoral spillover effects also the locus of problem attention and policy action is likely to shift to one policy to another, which, in turn, constrains or opens up further possibilities for policy change, at times, even for policy options that were politically blocked before. The composite effects of these temporally interrelated policy choices subsequently interact with novel changes in the international political economy.

A change in macro-economic policy can have important consequences for wage policy. But a change in macro-economic policy area does not immediately lead to policy changes in other areas. Sequential policy adjustment is an unbalanced process; it does do not follow a pattern of parallel policy change across different policy areas. There are often important time-lags involved in the sequence of adjustment among policy areas. Macroeconomic policy change can in technical terms move faster than policy adjustments in the sphere of industrial relations confronted with macroeconomic policy adjustment. For macroeconomic policy change all that is needed is to modify taxes, expenditures and interest rates. Policy changes in industrial relations are the outcomes of tough negotiations between the social partners or legislative changes that have to be passed through parliament. Spillover effects very often result in the fortification of the affected neighboring policy areas.

It should be emphasized that national policy responses are not independent from other national responses in an interdependent international economy. To be sure, towards the end of the 1980s the monetary policy choices made by the *Bundesbank* increasingly came to delineate the policy space for macro-economic policy choices in the majority of European political economies. The unique features of the linkages between different policy areas thus shape path-dependent trajectories of policy change. To give an example: the Swedish macroeconomic policy choice for a soft currency strategy to the fall in aggregate demand, resulting from the first oil shock, helped to restore Swedish competitiveness, while maintaining high levels of employment. When solidaristic wage bargaining eventually broke down in the face of a revolt from employers in the metal

sector, Swedish policy makers proved unable to contain inflation. When capital controls were lifted against the background of a domestic boom in the second half of the 1980s and when the Swedes finally decided to peg the Krone to the Dmark in the early 1990s, a surge in umeployment could no longer be avoided. The Scandinavian recession was exacerbated by the high real interest rate policy of the *Bundesbank* in response to Chancellor Kohl's decision for one-to-one conversion of East-German marks into Dmark over unification. The Netherlands, by contrast, followed a distinctly different adjustment trajectory. The basic choice for a hard currency policy in response to the second oil crisis incurred a tremendous blow to Dutch competitiveness, rising public deficits and a massive increase in unemployment. This condition of predicament persuaded the social partners and state policy makers, after a long period of political stalemate, to resume and revitalize a concerted strategy of wage restraint in order to recoup profits, investment and jobs. Fiscal discipline and wage restraint ultimate paid off in revolutionary job growth in the second half of the 1980. Moreover, low wages and increased demands for Dutch exports in the new German *laender* helped the Netherlands to successfully with the global recession of the early 1990s

By understanding the cumulative and temporal effects of international economic challenges, interdependencies between policy areas and time lags of interaction effects between policy choices adopted in different policy areas, are we able to more analytical grip on the contingent nature of policy adjustment and the overall impact of economic internationalization on the welfare state. While we are indeed extremely interested in country-specific patters of policy change, we are, at a more general level, interested in the comparative sequence of policy changes in across different policy areas. By carefully outlining internal sequences in the face of these three external challenges, showing how cumulative challenges impinge on domestic trajectories of policy adjustment.

2.2 Problem-induced policy learning

Policy adjustment takes place through trial and error. It is intentional in the sense that policy actors make choices, or, for that matter, decline to make hard choices for political reasons, with reference to specific goals. Policy making under increased international

constraints, very much revolves around priority setting, conflict resolution, policy coordination, and skillfully legitimating how to do 'more with less' in the areas of social and employment policies. Distributive conflicts are difficult to resolve under conditions of scarcity.

In our behavioral conceptualization of policy, policy makers are 'problem-solving' actors with cognitive limitations as a consequence of bounded rationality. We do not ignore self-interest, or its rational choice correlates of opportunism, externalization and rent-seeking, and the political calculations which influence policy actors' decisions to pursue policy change. These strategic and also normative orientations matter a great deal. However, we prefer to highlight the extent to which policy change can be understood in terms of learning, whereby policy makers attempt to adjust to changes in the policy environment in order to be able to effectively perform their designated functions in different policy areas. Problem-solving in policy does not follow a logic of functionally adjusting policies to new problem constellations. Relevant policy actors are critically constrained in capacities to adequate define the prevalent problem constellation, design viable policy solutions, must political support for their proposals, and implement preferred policy solution, while remaining open to new information and insights from policy experience, also from other countries.

We are particularly interested in the adaptive capacity of the welfare state. Welfare states may indeed be slow to adjust to changes in the international environment, but in our country sample there is a good deal of evidence that would argue that policy makers and corporate actors across many areas of social and economic regulation are capable of learning and adapting to emerging international constraints. In the process, policy makers seek to re-construct a novel match or 'goodness of fit' between the existing policy profile and the perceived policy requirements in the international political economy.

Usually set in motion by a change in the international political economy, trajectories of policy adjustment are marked by breaks, discontinuities, experimentation and ambiguities. The scope and capacity to change policy, however, is in a number of ways constrained. Policy choices are not only constrained by political and institutional conditions. Policy preferences are often ambiguous, and the more participants are engaged in the policy process, as they adhere to their own analysis of the problem at

hand, the greater the controversies will become with respect to defining a course of action. In different policy areas, different and sometimes even contradictory policy goals apply. For instance, an articulated policy objective in macro-economic policy may well be at variance with broadly supported policy objectives in the field of social policy. This implies that not any policy response can be adopted at any given moment in time, and, in addition, that the effects of viable policy responses do not always correspond to the prior intentions of policy makers. Usually, however, a critical audience of policy makers and the larger public are somehow monitoring the process and (intended and unintended) effects of policy adjustment. In other words, a large variety of actors can take part in processes of social learning, especially in times of perceived crises (Hall, 1993).

The concept of policy learning, employed here, has a neutral connotation. It should not be mistaken for 'getting smarter' in a rational sense to generate positive outcomes *per se* (Heclo, 1995). It is always possible for even smart people to draw the 'wrong' lessons from history; lessons which in turn exacerbate crisis-conditions. Rationally bounded policy actors face important cognitive and cultural constraints that may prevent them from finding, adopting and implementing effective policy choices (Simon, 1945). Actors in different policy areas adhere to very different understandings of the problems at the hand and of the consequences of the adoption of different policy options. Macro-economic policy makers may draw attention to accelerating inflation as the root cause of the crisis, whereas social policy and labor market policy experts would argue that growth should be stimulated by way of raising aggregate demand. To be sure, the international constraints of stagflation, high real interest rates and the liberalization of capital markers, which we, in hindsight, views as crucially important in constraining and shaping the scope for policy adjustment over the past decades, were far less well understood by the actual policy makers in the 1970s and 1980s. Still, it is our contention that policy makers are capable of policy reform once they have adequately learnt to understand the nature of the international challenges and the institutional constraints facing social and employment policy adjustment.

Following the canons of organizational theory, processes of policy adjustment follow a pattern of 'failure induced search' (March, 1994; Cohen and Sproull, 1996). Policies that were effective yesterday may become counterproductive overnight. Acute political crises

usually trigger the search for rather drastic reforms, prompting policy makers to believe that inaction might worsen current conditions. When policy performance falls below acceptable targets, when for instance stagflation becomes structural, search activity is increased. It remains politically very difficult to maintain a severe discrepancy between poor performance and unmet aspirations for very long. In periods of sustained poor performance, political pressure intensifies, which eventually induce even the most entrenched policy makers to come to understand that their standard rules of procedure are no longer adequate. Especially external triggers that discredit current policy making, create a large window of opportunity for policy change. Accumulated policy failures provoke a readiness for learning, engendering an 'unfreezing' process, in which old policy paradigms are shaken and new ideas can be accommodated (Hall, 1993).

Seen as learning, policy adjustment is an open and creative process. But it is also a painful process for the actors involved as it requires not only a willingness to improvise and experiment, but perhaps most importantly, to subject their pre-established policy ideas to critical insights, new information and experience. Dramatic policy mistakes, as they raise the overall problem load, can generate particularly important learning effects with long-term consequences for subsequent policy developments. The cathartic experience of the 'Dutch disease' in the 1970s is a good example of how policy mistakes generates positive learning effects, which, after a lengthy and painful period of policy immobilism, provoked a remarkable recovery of the Dutch economy and its welfare state. A shared recognition of policy failure is often an important cognitive precondition for policy change. A commen recognition of policy failure encourages the will to experiment, to open up the political agenda to discuss alternative policy solutions. Also the political crisis in Italy in the early 1990s serves as a good example of a comprehensive redesign of Italian political system in order to cope with the challenge of the EMU.

Policy adjustment is as much the outcome of 'puzzling' as it is a product of 'powering' (Heclo, 1974). Policy changes are more often the result of temporary political disequilibria than the outcome of intelligent policy analysis *per se*. At best, the two go together. A shift in the balance of power, to be sure, allows certain political actors to impose their definition and diagnosis of policy failure and its appropriate solution on the rest of the policy community. And as the political economy of the welfare state is made up of different

interdependent policy domains, accumulated policy failure can easily produce a struggle for political attention between different problem areas. Powerful actors will be able to stimulate search and mobilize resources for tackling problems they find most pressing, at the expense of other wrongs. With the passing of time, generally as a consequence of spillover effects, the locus of problem attention and policy action is likely to shift to a neighboring policy area, which may incur another shift in the balance of power. The issue of timing is crucial here. Pent-up frustration can be mobilized in a 'critical election' to result in the overall displacement of the old policy paradigm. The elections of 1979 in Britain, which brought Thatcher into power, and the extraordinary elections of 1997 in France, which brought the socialists back into office under Jospin, are cases in point (Hall, 1993). Organizational theorists emphasize the role organizational slack in processes of organizational change (Cyert and March, 1958). Slack accumulated in good times, can serve as a buffer in bad times. In the face of organizational decline, managers discover ways to decrease slack by cutting costs and through organizational restructuring. However, in the world of the policy and politics of the welfare state, normative aspirations and previous political commitments do not swiftly adapt to a decline in policy performance. The Golden Age of rising expectations saw the institutionalization of generous social benefits and egalitarian indexation mechanisms, which over time became appreciated by target groups as inalienable rights. It should in this respect be remembered that before the onset of the oil-price shock in 1973, the postwar compromise was challenged by the left, not by the right. The achievement of full employment and the expansion of the welfare state provoked the trade unions and left parties to articulate demands for the further extension in social protection, income redistribution, and worker control over corporate decision-making. To be sure, successes in extending job protection in Britain, co-determination in Germany, higher minimum wages and egalitarian wage indexation mechanisms in Belgium, Denmark, Italy and the Netherlands in the 1970s, subsequently interfered with and complicated the politics of adjustment in the next two decades. The achievements were perceived as entrenched social and economic rights, the more difficult politically it is to renege on these policy commitments.

Policy learning processes are inherently complex, given both the differences in the urgency attached to different problems in different countries, the multiplicity of objectives

at the stake, and plethora of relevant policy actors that have a say in the matter of policy adjustment.

2.3 Policy Coordination

The success of policy adjustment very much depends on the degree of policy coordination. However, there is no obvious correlation between the level of substantive interdependence between policy areas and the degree to which policy interdependencies are the object of explicit policy coordination in different welfare states. In an elementary fashion, we can distinguish between 'loosely' and 'tightly' coupled welfare states (Weick, 1976; Freeman, 1995; Ebbinghaus and Manow, 1998, Hemerijck, 1998). In 'tightly coupled' welfare states policy interdependencies are the explicit object of institutional coordination. By contrast, in loosely coupled welfare states, which characterized by a high degree of mutual indifference between different policy areas, there is a lack of modus operandi for issue linkage and policy coordination. In an ideal-typical fashion, policy adjustment in loosely coupled welfare states follows a pattern of spontaneously crosscutting spillover. The advantage of loose coupling lies in the swift mobilization of knowledge and resources to effectively address local problems through decentralized elaboration, innovation and implementation of policy goals. However, loose coupling can lead to sectoral fragmentation. Under conditions of uncertainty, decision ambiguities, divided loyalties, lack of policy focus, and coordination deficiencies across policy areas prevail in loosely coupled welfare states.

Lacking the strategic capacity for issue-linkage and policy coordination, while being confronted with unintended 'spillover' effects from other policy areas, sectoral policy actors adopt responses only with a view to their own problems, responsibilities, goals, and capabilities. At best, they follow a strategy of 'negative coordination' in avoiding the negative externalities emerging from neighboring policy areas (Mayntz and Scharpf, 1975).

Tight coupling denotes the circumstance where substantive policy interdependencies are the object of explicit policy coordination. A generalized recognition of policy interdependence is crucial: it is necessary for sectoral policy actors to see themselves as partaking in a more encompassing project of policy adjustment. Policy coordination relies

on ability of different policy actors to develop search for a *joint utility function*, which in turn depends on high trust relations among between sectoral policy actors and strong institutions for policy analysis and conflict resolution. Positive feedback from successful efforts at policy coordination is likely to reinforce the build-up of mutual trust, which is likely to encourage a further elaboration of strategies and institutions of joint problem-solving.
To be sure, many of the changes in the international political economy confront advanced welfare states with severe coordination problems. However, it should be recognized that in the case of a performance traps, which is often the result of a lack of policy consensus among interdependent policy actors, there is a real danger, particularly in tightly coupled welfare states, to lapse into a condition of institutional self-blockage, foreclosing the elaboration, adoption, and implementation of effective policy responses (Scharpf, 1988). The crucial issue in tightly coupled welfare states is really how policy interdependencies are *politically* managed.
One caveat is in order: Loose and tight coupling should be viewed a variable concept rather than as clear-cut country-specific institutional factor. The degree of coupling between policy areas differs greatly among countries. In the process of policy adjustment we encounter both successful and unsuccessful policy strategies of tight coupling, de-coupling and re-coupling with respect to different policy areas in different countries.

3 Six Policy Areas

The dynamic of policy adjustment, we argue, has to be understood in terms of the composite and temporal character of interdependent policy choices adopted across different policy areas over time. We distinguish between six interdependent economic and social policy areas, which have all been directly or indirectly affected by increased economic international interdependence and competition. These are macro-economic policy (including fiscal, exchange rate and monetary policy), industrial policy and regulation, wage policy and industrial relations, tax policy, labor market policy, and social security policy. This set in not exhaustive but it does embrace those policy areas, which have drawn much political attention in policy processes in different countries over the past three decades.

During the Golden Age of postwar prosperity different advanced political economies achieved relatively stable, coherent and functional clusters of macro-policy, industrial policy and regulation, wage policy and industrial relations, tax policy, labor market and social security policy and regulation. These six policy areas developed as relatively autonomous, functionally separated, policy domains, each with their own sector-specific methods of provision, regulation, and governance. Although fundamentally engaged in the tasks of meeting and stabilizing the material needs of citizens, the six policy areas varied in substantive policy content and were governed according to different rules of policy making. The crisis of stagflation, low growth and the resurgence of mass unemployment, have, since the mid-1970s, come to unsettle the basic policy repertoire around which the welfare state is organized.

What is of special importance for analyzing policy change is the degree to which different governments in different countries are potentially able to exercise control over these six policy areas, or the autonomy of non-state actors in the governance structure of different policy areas. These differences in governance structures across different policy areas is crucial for explaining policy change. Macro-economic policy most often falls under the jurisdiction of state, but monetary policy can also fall under the control of an independent central bank. Industrial relations usually. In some countries the sphere of industrial relations, beyond regulation over the right to organize collectively, negotiate binding agreements, and general conditions of employment contracts, is fully autonomous from state intervention, as in the German system of industrial relations, under the constitutional requirement of *Tariffautonomie*. In other countries there is a strong history of state intervention in industrial relations, whereas in other parts of the world political authority over industrial relations is 'shared' by the state and the social partners. Also in the area of social security there are important institutional differences. In the universalist Scandinavian countries, social security falls under the jurisdiction of the state. In Bismarckian continental system, there is a tradition of associational self-regulation by the social partner, as a corrollory of payroll financing. A similar variation in institutional governance, ranging from a state monopoly, to shared policy making authorities between public and private actors, to complete independence with local and regional variations, can be observed in the area of labor market policy in different countries. These

institutional differences constrain and enable the capacity of the state to intervene into self-regulated policy areas. They circumscribe the possible degree of issue-linkage between and sectionalism within different policy areas, and delineate the options for political exchanges, side-payments, and negotiated agreements between different policy actors, in different policy areas (Ebbinghaus and Hassel, 1999).

3.1 Macro-economic Policy

Under the heading of macro-economic policy we group together fiscal policy, exchange rate and monetary policy. Together they serve the broad goals of macro-economic policy – stability of employment and prices, economic growth, and balance in external payments. Fiscal policy refers to the use of taxation and government expenditures to regulate the aggregate level of economic activity.

In the aftermath of the oil-price shocks and the destruction of the Bretton-Woods system of fixed exchange rates, the volume and the volatility of international capital movements dramatically increased. As a result, national macro-economic policy choices became more interdependent. When mass unemployment reappeared after the first oil-price shock in the 1970s, the dominant macro-economic policy response was inspired by Keynesian macro-economic theory. In face of the crisis of stagflation the reputation of Keynesian macro-economic management waned, leading in the 1980s to a conversion to monetarism and supply-side economics. Restrictive fiscal and monetary policy programs were adopted in the United Kingdom, Germany, Belgium, the Netherlands, Denmark and Austria. After France failed to independently pursue an isolated Keynesian growth strategy in 1981, an immanent currency crisis forced the French socialist to endorse a policy strategy of *désinflation compétitive* in 1983. Only Sweden and to a lesser extent Italy remained faithful to a policy strategy of strategic devaluations as the appropriate response to a loss of international price competitiveness during the 1980s. However, from the late 1980s onwards, pressured by the internationalization of financial markets, Sweden reluctantly endorsed price stability and independent central banking as macro-economic policy priorities. Italy, on the other hand, committed to meeting the Maastricht

inflation and deficit criteria for entering the European Monetary Union, embarked on an impressive effort at macro-economic stabilization in 1990s.

3.2 Industrial Policy and Regulation

Industrial policy is geared towards channeling and guiding the direction of economic activity with the use of public resources, ranging from regulation to subsidization. Interventions range from the reactive subsidizing ailing firms and encouraging rationalizations during recessions towards a proactive policy strategy of supporting potential 'national champions' in the race of global competition.

Over the past decades the emphasis of industrial policy has shifted from the support for ailing large industrial conglomerates towards the promotion of growth of small and medium sized firms. In economic regulation, tariff barriers and quantitative restrictions on imports have largely been canceled. Furthermore, privatization in infrastructure, natural monopolies and service branches such as air, rail and road transport, telecommunications, television, energy, banking and insurance, have been pursued in the majority of the countries in our sample, with an eye on lowering public expenditures.

3.3 Wage Policy and Industrial Relations

The domain of wage policy and industrial relations structures the relationship between the trade unions and the formal employing organizations of the labor market, and regulate, under labor law, procedures and coverage of collective bargaining and the scope of consultation, representation and cooperation of the two sides of industry. Wage policy in the more narrow sense refers to attempts, closely related to macro-economic policy, by the government to influence or control wage developments. This can be achieved by way of intervention, through for instance the imposition of a wage freeze, or more indirectly by persuading trade unions and employers' associations to voluntarily exercise wage restraint, in a cooperative effort to curtail inflation and promote competitiveness.

In most of countries in our sample we observe a strong tendency towards the decentralization of collective wage bargaining and the dismantling of corporatist practices

of policy concertation, pushed by business interests and a secular decline in trade union membership. The most dramatic deinstitutionalization of corporatism took place in Sweden, where after a decade of inter-organization turmoil, Swedish employers formally withdrew from all tripartite bodies in 1992. By contrast, we also observe a remarkable resurgence of corporatist forms policy coordination in a number of continental countries, notably Austria, the Netherlands and Italy, where organized wage restraint have contributed to macro-economic stability, competitiveness, and even to an increase employment in the 1980s and 1990s. While many of the new social pacts over wage restraint in Europe are geared toward the fight against unemployment, they also, and perhaps most conspicuously in Italy, have been directed at securing participation in EMU.

3.4 Tax Policy

Tax policy is about compulsory levies on private individuals and organizations made by the government to raise revenue to finance expenditures on public goods and services. Taxes are classified in various ways, ranging from direct (income and wealth) to indirect (excise duties, custom duties on imported goods and value-added) taxes. Some welfare programs are tax financed, while others rely more on contributions.

From the mid-1960s to the mid-1980s, the share of total tax revenues in GDP has steadily increased. During the last decade, however, this trend seems have come to a hold in the face of the fear of tax competition and the paramount unwillingness of citizens to pay more taxes. Since in most welfare states the burdens of unemployment, health care and pension systems have continued to rise, the leveling off of tax revenues does suggest that advanced welfare states have come under severe financial strain. The preferred policy responses to the stagnation of public-sector revenue in a number of countries in our sample has been to reduce nominal rates of corporate and personal income taxes while at the same time broadening the tax base by eliminating exemptions, together with a distinct shift from mobile to less mobile or immobile tax bases. Personal income taxation has increased slightly, and in particular government revenue for consumption taxes and social insurance has been increasing.

3.5 Labor-Market Policy and Regulation

Labor market policy entertains a tenuous position between insiders and outsiders in the labor market. The 'right to work', difficult to uphold in a capitalist economy, is commonly anchored in public commitment to pursue full employment by way of an active labor market policy. Labor market regulation typically lays down the procedures of working conditions, job protection, and hiring and firing legislation.

The deregulation of labor markets, the flexibilization of employment conditions and work organization, are the master trends in the area of labor market policy and regulation in the past two decades. In addition, active-labor-market strategies to improve the employability and mobility of workers are employed everywhere. However, given budgetary constraint and the insufficient number of vacancies, especially for low skilled groups, active policy initiatives have become less effective. Policies aimed at increasing the demand for labor in the sheltered sectors through employment subsidies have gained in importance. The same holds true for policies of vocational training, retraining and education, aimed improving the quality of a high skilled work force. Voluntary working time reduction with or without (full) wage compensation has been on the policy agenda of many advanced welfare states ever since the late 1970s. In France, new legislation was adopted to introduce a compulsory the 35-hour-week by the year 2000. Italy followed suit.

3.6 Social Security Policy

Social security regulation is politically disengaged from the regular labor market, serving to protect the non-working population - the aged, the sick, and the unemployed - by providing them with sources of income, social security and public assistance. Social security benefits may be paid for by contributions from workers or their employers, or by general taxation, and benefits may or may not be means tested.

In the wake of the two oil shocks, especially on the European continent, social security policy has been deployed to allow for a reduction in labor supply through early retirement, sickness and disability pension. In the 1980s and especially the 1990s increasing pressures on the public budget, mainly caused by rising unemployment, favored cut-backs

on social expenditures. In many cases, benefit levels have been reduced, replacement rates lowered, duration of social insurance benefits shortened, retirement ages raised, while eligibility criteria have been tightened and more effective eligibility controls have been introduced. Moreover user-charges and co-payments in health care, child care and education were increased significantly in many countries. . The basic social policy requirement seem to have become: 'how to do more with less'.
However, there is no general tendency of welfare state retrenchment across all countries and all fields of social policy. . Not only is there substantial variation in the degree to which social benefits have been curtailed, but a range of countries also enacted benefit improvements in some social policy programs, such as the extension of the unemployment benefits in Italy and Switzerland, improved child benefits and introduction of a care insurance in Germany or pension benefits increased in Denmark. However, there seems to be a major policy trend in practically all OECD countries to reform the national systems of social security towards a stronger emphasis on work incentives (from welfare to work), e.g. by a tightening of eligibility conditions for unemployment benefits and a reduction of benefits if recipients refuse job offers (see OECD 1998, Benefit systems and work incentives, p. 49). On the contrary, programs that are comparatively detached from the labor-market, such as pensions, have so far, by and large, only been curtailed to a minor degree. Those benefits, however, which support labour market participation, such as family and elderly services, were even expanded substantially in recent years[1].

3.7 Policy-interdependencies, exposure and politicization

The interdependencies between the policy areas of macroeconomic policy, industrial policy, wage policy and industrial relations, tax policy, labor market policy and regulation and social security policy, in the context of international economic integration, are fairly obvious. In the open economy, generous standards of social security are critically dependent upon international competitiveness to create wealth, employment and a tax-base for welfare programs. By the same token, the degree of public protection from

[1] On average, the shares of these services in GDP has increased from 1.12% in 1980 to 1.63% in 1995 (OECD 1998, Social Expenditure Database 1980-1996).

market forces offered by the welfare state affects the competitiveness of advanced welfare states. Restrictive macro-economic policies can have a negative impact on growth and employment. Countries facing high public debts, confronted with major increases in real interests rates, face strict limits on any policy strategy to fuel effective demand via increasing public expenditures on ambitious industrial policy and active labor market policies. Wage moderation can help to ease the burden on monetary policy, by allowing for monetary expansion and low interest rates. Likewise, the commitment to a non-accommodating monetary policy can make it easier for the trade unions to support a protracted policy of wage restraint. Effective labor market policies, resulting in the reintegration of redundant workers in the labor market, can reverse the increase in long-term unemployment, especially when skill levels are sufficiently raised. Labor market deregulation and decentralization of collective bargaining in the face of falling demand for labor is unlikely to add to job growth. Similarly, in a weak economic climate, labor market deregulation is likely to result in labor shedding. Social security curtailments and labor market deregulation work best when the economy is generating a reasonable number of vacancies. Tax-financed basic-pension schemes can serve to encourage the further proliferation of part-time employment. By contrast, in countries where adequate old-age pensions depend on insurance contributions based on life-long, full-time employment, „breadwinners„ cannot easily switch to part-time work. There are also aspect of functional equivalency between different policy areas. For instance, the absence of an adequate safety net, in Italy and other Mediterranean countries, seems to have been compensated by generous measures of employment protection. By contrast, in Denmark, generous social protection goes together with rather liberal measures of labor market regulation. Finally, the success of policy coordination backed up by effective institutions for conflict resolution, issue-linkage, policy analysis, and problem solving, can encourage participant actors to adopt long-term, public-regarding strategies of decision-making and collective action. This latter institutional point will be taken up extensively in the next chapter. Policy adjustment, however much constrained by consecutive changes in the international political, is a political process. Changes in macroeconomic policy, industrial policy, wage policy, tax policy, social security and labor market policy are political decisions. The six policy areas, exemplified above, can be conceptually placed on a spectrum between

international economic exposure and domestic political control (see diagram xy) . While no policy area is totally shielded off from the effects of economic international environment, some remain more fully within the capacity of domestic control than others. To be sure, macro-economic policy, wage policy and tax policy, are more directly exposed to changes in world markets than are labor market regulation and social security policy. Indeed, with respect to macro-economic policy, today, there is a large degree of policy isomorphism to cope with international economic pressures. During the 1970s and early 1980s, macro-economic policy could still be used as a buffer to protect the existing policy profile. Particularly, Swedish policy makers were pretty effective in deploying macro-economic policy as a buffer for adjustment, by accepting a higher rate of inflation and compensating this by strategic devaluations of the Krona in order to contain competitiveness.

Diagram xy: International constraints and institutional diversity of policy areas

In other words, some policy areas, which once were led purely by domestic political considerations, have become more constrained by increased international economic

interdependence over the past decades, than other policy areas, which are more indirectly, through spillover effects, implicated in the process of policy adjustment. For example, even though social security policy, especially employment-related programs, is surely affected by the international economy, there is a large degree of evidence in our study of the resilience of cross-national differences, which also applies to industrial relations and labor market policy and regulation. These policy areas so far remain solidly within the jurisdiction of the nation-state. This is reflected in the large differences in policy design across different welfare state and the importance of national institutions and policy actors in the administration of these policy areas. Prevailing institutional structures and their constituent clientele, parties, special interest groups, and street-level bureaucrats are likely to put up strong resistance to reform. By making intelligent use of prevailing institutional arrangements, these are often able to refract and modify in their favor the proposed policy changes through existing arrangements.

As we move from macroeconomic policy choices to the spheres of industrial relations, social security and labor market policy, distributional conflict over policy adjustment looms large. Policy changes in these areas are riddled with sensitive political contingencies. Deunionization in the area of industrial relations, deregulation of labor markets, and retrenchment of welfare programs are all likely to be confronted with stiff political resistence. This for three reasons. First of all, these areas are based on deeply entrenched normative understandings of economic security, equality, social justice and mutual solidarity, and social partnership, which transcend and in times of economic dire straits contradict the values of economic efficiency, price stability and growth. Second, industrial and social rights are attached to groups, who will surely resist any curtailment of acquired rights. If internationally exposed wages are sticky, like economist argue, than generous social rights, indexation clauses, and job protection regulation, enshrined in law, are probably even more so. This makes it politically extremely difficult for policy makers to simply economize on social rights and labor market regulation in hard times. And given the obvious material importance of employment and social security in the lives of many citizens, especially in times of crisis, the politics of 'dismantling the welfare state' surely is not an attractive ticket for political competition (Pierson, 1994). To be sure, a significant raise in interest rates by an independent central bank does not lend itself to the kind

political dramatization of a substantial cut in benefit levels. Macroeconomic decisions, often no less important for the life chances of ordinary citizens, are by and large technical in nature and moreover remain pretty insulated from larger social pressures and political mobilization. Macroeconomic policy choices unleash political conflict more indirectly, as we have argued, through spillover effects. The French policy shift to 'competitive disinflation' indirectly led to an eruption of militancy and a period of protracted social strife. The French government subsequently imposed an incomes policy on public sector unions. Only in the face of a very high level of unemployment, weak unions, and deregulated labor markets, was the French economy able to deliver on the objective low-wage inflation. At a later stage, with respect to social security, retrenchment proposals were significantly modified and some rejected altogether. Finally, social rights and services are embedded in localized institutional arrangements and methods of provision. As we have already indicated, more often than not, the state is not the sole provider and regulator of industrial and social rights. The social partners, professional street-level bureaucrats, and specialized regional agencies are often involved in the operation, implementation and administration of industrial relations, social security, and labor market policy. Together, these normative, political, and institutional conditions with respect to the spheres of industrial relations, social security and labor market policy make the political management of policy adjustment in economically advanced welfare state particularly difficult.

As we will highlight below, that while there has been some convergence in macro-economic policy and tax policy across economically advanced welfare states, systems of industrial relations, social security and labor market regulation have not. There are still important measures of policy latitude in these politically protected policy areas. Moreover, we should be aware of the possibility that a loss of regulatory competence in one policy area can be compensated for increased leverage in another policy area. Denmark is a case in point. The Danes were far less successful in the fight against stagflation in 1970s and early 1980s than the Swedes. Notwithstanding earlier policy failures, Denmark improved its economic and employment performance in the 1990s, not through independent macro-economic policy but by de facto pegging the Danish currency to the Dmark, which in turn enabled Danish policy makers to focus more on organized wage

restraint in the policy area of industrial relations under the shadow of a restrictive monetary policy. Also tax policy change offers a good example of the adaptive capacity of the welfare state. It is often argued that open capital markets and global currency markets constrain governments to raise taxes. Although this is true, many countries are in process of learning how to raise revenues in other ways, by way of vouchers and user charges for social services.

Politicization and exposure are not static entities. The degree of exposure and the extent and focus of politicization change over time. To be sure, in the 1970s crisis of stagflation the management of the economy was at center of the resurgent cleavage of between Left and Right. The policy focus was on macroeconomic policy. Two-digit levels of inflation, reaching 26 percent in the UK, in the face of rising unemployment, gave conservative governments in many countries an important window of opportunity to replace Keynesian fiscal reflation by monetarist policies. When in the second of 1980s the world economy was growing, inflationary pressures subsiding, but unemployment remained high, especially in Europe, politicization, policy attention, and reform action shifted to the areas of industrial relations, social security, labor market policy and regulation.

3.8 Welfare states are different

Welfare states are different. This reflects differences in cultural traditions, policy design, and methods of financing and administration. Many of the idiosyncrasies in national patterns of policy adjustment are directly related to the specifics of national systems of social policy and industrial relations (Esping-Andersen, 1990; Ebbinghaus and Visser, 1998). The great achievement of the literature of the families of welfare states and varieties of capitalism lies in their having brought a large degree of coherence back into the contingencies of advanced political economies. However, thus far, there is little attention to the composite dynamic and interactive character of social and economic policy adjustment. Many authors continue to focus on the regularities of social policy reform that are typical of the resilient institutional characteristics of different models (Esping-Andersen, 1996; Pierson, 1994; 1996). But, as policy actors, engaged in processes of sequential problem displacement and policy learning across different policy

areas, call important aspects of the established rules of the game of policy making in to question, these institutional parameters loose their portent as explanatory variables. This is particularly true of the 1990s.

By drawing attention to policy change, we are not advocating a radically indeterminist perspective. What we observe in the countries of our study is neither the seamless flow of events, nor the resilience of the status quo, but rather a dynamic of policy adjustment that is driven by cumulative constraints imposed upon advanced welfare states by changes in the international political economy and the composite character of the endogenous circumstances of timing, interaction, and learning effects that push and pull trajectories of policy adjustment into different directions. We are in full agreement with the basic institutionalist proposition that history matters, in particular, that political institutions and earlier policy choices shape the constraints and opportunities for consecutive policy choices. We are critical, however, of the presumption that policy choices in different areas of social and economic regulation are somehow synchronized in their operations, in the sense that coherent policy changes can be read off from prevailing institutional and policy profiles. We propose a more relaxed understanding of the 'relative' coherence of different families of welfare state, which allows for temporal variation among the six policy domains we have selected for the empirical study of policy adjustment.

The academic debate over globalization is often couched in terms of the misleading dichotomy of convergence and divergence (Berger and Dore, 1996). We prefer to highlight on the composite interaction, timing and learning effects across different policy areas. In some of these policy areas there has indeed been considerable policy convergence as result of international economic interdependence, such as in macro-economic policy. In turn, macro-economic policy convergence reach deep into the fabric of labour market and social security policy. But it is the sequential and composite interaction effect of policy convergence in one area and diversity other policy areas that shape national patterns of policy adjustment and their successes and failures. Policy adjustment under international constraints involves an interactive restructuring of national policy profiles of social and economic regulation. It is both an economic and a political process. As countries learn from foreign examples, they will do so only in a manner that is

adjusted to standard routines and traditions, serving to re-contextualized 'best practices' from elsewhere.

The emergent policy profiles that we encounter in this study are very likely to be rather different from the 'purer' models of the welfare state that developed under the conditions of complete political autarky across policy areas when the welfare state expanded in the 1950s and 1960s. It is not possible to predict how concrete policy areas will reposition themselves in the future, how they shed, acquire, and exchange new functions and responsibilities, and whether ongoing repositionings of policy areas will result in a new 'goodness of fit' across policy areas.

This is a study about the adaptive capacity of the welfare state. The focus on timing, learning and interaction effects across relevant policy areas is analytically and empirically useful in understanding and studying how processes of policy adjustment evolve. This analytical framework enables us to analyse and sketch contingent trajectories of policy adjustment without forcing ourselves to choose between policy convergence and divergence.

With these caveats in mind, we stipulate, in agreement with the relevant literature, four loosely coherent policy repertoires for the Golden Age of postwar prosperity. The four policy repertoires of the Christian-Democratic Continental, Republican-Mediterranean, the Social-Democratic Nordic, and the Liberal Anglo-Saxon countries in our sample, summarized in Table 1, serve as the basic 'startup constellations' for the comparative analysis of policy adjustment from the 1970s to the 1990s. In the next four paragraphs we portray the trial and tribulations of adjustment per country group during the past three decades. In the next three sections, summarized in tables xy, we highlight the more important policy changes adopted per decade for the six selected policy areas in our country sample. In the lower four rows of the tables we evaluate the record of performance, again per decade, by means of various indicators which are to grasp the ability of national welfare regimes to reach both efficiency and equality, combining macro-economic stability with high levels of employment and social security .

4 Germany and its smaller neighbors

Catholicism and Protestantism left strong historical markings in the welfare states of Germany, Austria, the Netherlands, Belgium and Switzerland. Macro-economic policy priorities for all five countries have on the whole been fairly restrictive, particularly with respect to monetary and exchange rate policy, as the continental welfare states favor stable prices and hard currencies. The central bank in Germany, Belgium and the Netherlands are independent. Austria, lacking an independent central bank, by and large, follows a policy of a stable exchange rate to the German Mark. The same holds true for Switzerland. Industrial policy is not interventionist, but rather enabling, supporting high-skill high-quality production through long-term patient capital. Compared to the more interventionist industrial policies in Austria and Belgium, the Dutch and the Swiss traditions are more 'hand off'. Austria for a long time presided over a large nationalized industry basis. All the continental economies are export-oriented and with relatively high wages they have to compete in high quality products and services and require a highly skilled work force.

In the industrial relations literature, the continental welfare states are usually grouped under the label of intermediate bargaining systems. Collective bargaining predominantly takes place at the sectoral level, but there is a high degree of inter-sectoral coordination, through institutions of wage leadership, and macro-policy concertation, through corporatist institutions, which are most developed in Austria and least in neighboring Switzerland. The coverage of collective bargaining is high, while coordination between trade unions and employers associations at the peak level is considerable. Invariably, collective agreements have a legally binding status. The level of industrial conflict is low and if strikes occur, they are highly organized. In Belgium and the Netherlands there is a strong tradition for state intervention in industrial relations. In Germany, state intervention is disallowed by the principle of *Tariffautonomie*, laid down in the Constitution. Statutory works councils and co-determination legislation support worker participation and a consensual style in labor-management relations at the workplace.

In the welfare state literature, Austria, Belgium, Germany, the Netherlands and Switzerland are usually grouped, together with France and Italy (see below), under the label of the regime-type of the continental, 'Bismarckian', conservative or Christian

democratic welfare state (cf. Kersbergen 1995; Esping-Andersen 1996c, 1990).
Continental social policy is based upon the Bismarckian principle of industrial insurance against occupational risks, financed by earmarked payroll contributions from employers and workers. Employment-related social security programs revolve around income replacement and are targeted at the (male) breadwinner in order to safeguard traditional family patterns. Social insurance typically excludes non-working wives of breadwinners and special family allowances encourage motherhood and full-time housewives. As important financiers to the system (through premiums and contributions), the social partners are strongly involved in the management, administration, and implementation of social security provisions. The continental systems are transfer-heavy and service-lean. Strongly committed to traditional family relations, there is, in contrast to the Nordic model, a distinct underdevelopment of public social services.

The status of labor market policies is strongly correlated with the overall character of social security. Whereas the Scandinavian welfare states are famous for their strong emphasis on active labor market policy, the continental welfare states seem to have placed 'welfare before work'. Public sector employment is also low compared to the Nordic countries. Continental labor markets, moreover, like their Nordic counterparts, are highly regulated. Levels of employment in the early 1970s stood at about 60 percent, with very low levels of female employment.

The particular combination of disinflationary macro-policy, coordinated sectoral bargaining, payroll financing of the system of social security, and the lack of an active labor market stance, have had important consequences for the roads of policy adjustment traveled in Germany, Austria, the Netherlands, Belgium, and Switzerland over the past three decades. The core linkage in these countries revolves around the nexus between the sphere of industrial relations and the system of social security. The 'tight coupling' between sectoral industrial relations and payroll social security, in the 1970s and 1980s, came to serve as an institutionalized support structure, allowing the social partners to externalize the costs of economic internationalization onto the social security system (Hemerijck and Manow, 1998). In Germany, the Netherlands and Belgium this strategy of labor-supply reduction through the welfare state reached crisis proportions in the 1980s and 1990s.

4.1 Germany

Germany is the largest economy in our sample. For most of the postwar period it was the motor behind European reconstruction and prosperity. As a relatively open large economy, its smaller neighbors have become highly dependent on exports to Germany. In turn, German economic policy choices are highly influential in the economic performance and the policy choices of Austria, Switzerland, Belgium, and the Netherlands. This is also true of Denmark and, more recently, Sweden. After the collapse of the monetary regime of Bretton Woods, many of these small open economies gradually remodeled their social and economic policies, especially their macro-economic policy priorities, after Germany's. In the process, the D-mark gained in importance as the anchor of the currencies of the smaller European economies.

The German welfare state is rightly considered the exemplar 'continental' welfare state. The core policy interdependency in the German welfare state, which also holds true for many of its confessional neighbors, lies between industrial relations and social security, because continental social policy is in large part financed out of payroll contributions. However, in Germany, policy coordination is confronted with three important institutional constraints. These affect monetary policy, wage policy and tax policy. The independence of the central bank is endorsed by the federal banking law, the principal of the autonomy of wage policy, *Tariffautonomie*, is guaranteed by the constitution, and, fiscal policy falls under the jurisdiction of the governments at both the federal and the state level. Moreover, the constitutional court limits the government's juridical room of maneuvering. In many cases its decisions have also far-reaching financial consequences for the public budget. These institutional constraints surely complicate issue-linkage and policy coordination in the event a major disruption in normal policy-making.

Already since the mid-1980s there has been a growing concern that Germany was losing its attractiveness for international investors as a *Standort*, because of high levels of taxation and numerous rigidities in the labor market and the welfare state. The unification with East-Germany in 1990 presented an unprecedented challenge. Perhaps precisely because the condition of extreme chaos and uncertainty that went along with it, unification induced a 'conservative' response in the German pattern of policy adjustment. German

policy makers essentially carried out the transformation of the five new *Laender* in a manner that was in many ways 'tried and familiar'. This, however, intensified the already roaming pathology of 'welfare without work'.

4.1.1 Macro-economic policy

After the collapse of the system of Bretton Woods, the Bundesbank switched to a very tight monetary policy in 1974 so as to curtail inflation. The German government turned to fiscal reflation, which resulted in an increase in the budget deficit in 1975. As the Bank stuck to its tight monetary policy the Federal Republic was in the midst of a recession, resulting in low growth rates, a fall in employment, a rise in unemployment to over one million, against a strongly appreciating D-mark. In 1976 fiscal policy tightened to consolidate the budget, after which the government pursued another round of fiscal revelation. In the wake of the second oil-price shock, fiscal policy was again expansionary. In the second half of the 1980s macro-economic policy and wage policy worked together much more smoothly than during the first half of the 1980s. Inflation had fallen from 6.3% in 1981 to 2.1% in 1985 and was practically zero in the following two years. as a result of moderate wage policies and falling oil prices,. Growth picked up in early 1984 and gained momentum afterwards. In the second half of the 1980s, continued wage moderation and low levels of inflation set in motion a recovery, which also stimulated job creation and helped to reduce unemployment from 8% in 1985 to 5.6% in 1991 (OECD, Labor Force Statistics).

In 1990 unification changed things dramatically. The East-German economy immediately collapsed in the face of western competition. The conversion rate of 1:1 for cash deposits and 2:1 for savings more or less destroyed the competitiveness of East German companies and led to a collapse of production and employment. In response to the widespread fears that monetary unification and rising budget deficits might again fuel inflation, the Bundesbank adopted a very restrictive policy between 1990 and 1993. Tied to the German mark, partly through the EMS, other European economies were forced to follow suit, which forced Europe into a deep recession. Wage increases during the initial unification boom exacerbated the situation. The loss of competitiveness was made up for by a strategy of massive labor shedding. Instead of financing the massive transfers to the

East via higher value-added taxes and lower public consumption expenditures in the West, the Kohl government raised the deficit and social security contributions. In addition, the government introduced a 'solidarity' tax. The increase in social security contributions created additional wage pressure. The appreciation of the D-mark following the EMS crisis in 1992 intensified the recession. After 1994 fiscal policies became increasingly restrictive in order for Germany to meet the Maastricht convergence criteria. Since 1996, the depreciation of the D-mark paved the way for an export boom but so far, the external impulse has not been strong enough to invite to a surge in investments that could have led to an increase in the number of jobs.

4.1.2 Wage policy and industrial relations

In the wake of the second oil-price shock, German unions and employers began to adjust their behavior to the anticipated non-accommodating policy stance of the central bank. A kind of implicit or covert form of coordination between monetary policy and wage coordination developed, in spite of, or perhaps paradoxically, because of central bank independence and *Tarifautonomie.* A pattern of „institutionalized monetarism„ emerged whereby wage demands came to mirror the publicly announced growth in the money supply to which the Bundesbank committed itself. However, the high wage/ high quality German model of the 1980s was only viable for as long as the social security system was able to absorb small number of redundant workers whose productivity fell behind average productivity developments in German industry. Again, unification changed the situation dramatically. Employment in the exposed sectors dropped dramatically. After 1992 unemployment rose again. To be sure, the system of industrial self-governance or covert policy coordination was not up to the task of the challenge of unification. In 1996 the Kohl government called both unions and business associations to the bargaining table to talk about a moderate wage settlement in the west and delayed adjustment of eastern wages to the western levels, and to step up investments in the new *Länder.* The talks over the 'Alliance for Jobs' failed in the face of the government sick pay reform package. The unions walked out of the talks in April 1996. The government and the social partners proved again unable to adequately link the policy problems and solution in the areas of

industrial relations and social security.

4.1.3 Social security policy

The oil crises of 1973 and 1979 immediately turned into financial crisis of the welfare state as unemployment rose while contributions into the system depleted. This financial predicament is typical of the continental welfare state as a rise unemployment immediately results in a fall of contributions to the unemployment insurance funds, if rates are immediately raised. This already forced the Schmidt government to pursue a more restrictive fiscal policy. As a consequence, in the 1970s and early 1980s, the German public deficit did not grow as fast as in other European countries. Incremental cost cutting was relatively effective in containing the rise in social spending, while the extensive system of social security more or less remained intact. As a result, total social expenditure, as a percentage of GDP remained remarkably stable. In spite of the overall competitive success of the German model, the welfare system was increasingly used as an instrument of labor shedding after 1980. Only after unification, Germany became trapped in a pathological vicious cycle of 'welfare without work'. A complicated pattern of mutual interaction between investments, productivity increases, labor participation, rising wage costs and (non-wage) social security arrangements became operative.

Under increased competitive pressure, (West-) German firms in high wage sectors can really survive if they were able to increase productivity. This was, in part, achieved through labor-saving investment strategies, raising productivity levels of workers through high quality vocational training and education, and/or by laying off less productive or 'too expensive', mostly elderly, workers. High minimum wages and substantial non-wage labor costs thus engendered an 'inactivity trap', whereby the virtuous cycle of productivity growth and competitiveness in the second half of the 1980s gave way to a vicious cycle of high wage costs, exit of less productive workers and rising social security contributions in the wake of unification. This required further productivity increases on competitive firms, which elicited another round of reductions in the work force in the 1990s. Employment disappeared in the East where productivity was too low to begin with. Moreover, as service sector salaries were intimately tied to exposed sector wage developments, this

logic created an additional constraint for job-growth in the labor-intensive public and private service sectors, especially at the low end of the labor market. The inactivity trap, moreover, was reinforced by government policy. In contrast to the general tendency in Europe in the 1980s and 1990s to shift the financial burden of the welfare state from producer groups to the public sector (is there any empirical evidence for this statement? According to our figures, the share of social expenditures financed by contributions remained very stable between 1980 and 1995), the German policy response ran in the opposite direction: while raising the burden of adjustment on labor, the state essentially retreated from welfare state financing. After unification social insurance funds thus came to bear a considerable part of the immense financial transfer from the west to the east.

Throughout the 1980s and 1990s, early retirement schemes, disability pension and extended unemployment insurance gained prominence as attractive pathways of labor shedding. The Kohl government was utterly unable to reverse the cycle of welfare without work in the wake of German unification. Because unemployment and many other social benefits are tied to the wage level, many of the jobless in the east are better off since unification in terms of their disposable income. Stricter criteria for acceptability of the job-offers for the unemployed together with various cuts in the level of unemployment benefits have not been able to stem the tide. Only recently beyond the traditional strategy of cost cutting and burden shifting, through various measures loosening the 'acceptability' criteria in the unemployment and pension insurance and the intimate ties between previous wage and benefit levels. The reform of social assistance scheme in 1996 introduced the opportunity to combine social assistance with wages for 6 months, in order to strengthen the incentives for welfare recipients to return to work. Various other reforms in the unemployment insurance also go into the direction of more 'activation', including a shortening of search time and the obligation of the unemployed to take up jobs below their former skill and earning levels, together with measures to avoid net income losses when an unemployed person moves out of welfare and back into work.

4.1.4 Labor market policy

Throughout the period under study, German labor market policies, like in many other

continental welfare states, remained fairly passive. There is a pro-cyclical character to German labor market policies because revenue of the federal labor office is, like the rest of social policy, financed out of payroll taxes. Policies to reintegrate the unemployed, however, gained in importance in the second half of the 1980s and especially after German unification. Massive lay-offs in the East were partly absorbed by active labor market programs. The traditional German labor market response to low economic growth and increased labor supply, has been to reduce weekly and annual working time and a further increase in part-time work. Pushed strongly by union demands, the average hours worked fell from 41.6 hours in 1980 to 37.7 in 1996. Part-time work is not widespread in comparative perspective and the majority of part-time jobs in Germany are held by women. The German welfare state, the intimate ties between welfare entitlements, previous earnings and the periods for which contributions have been paid, Manow and Seils argue, stands in the way of a further expansion of part-time jobs.

4.1.5 Tax Policy

After 1982 we observe a shift in tax policy towards a preference for the broadening of the tax base while cutting rates. In 1983 VAT taxes were raised. In the second half of the 1980s there has been a leveling out of tax progression in favor of middle income strata, together with increases in excise taxes, and special tax allowances for SME's. When the government decided to finance part of the subsequent tax reform policy package in 1987 through the introduction of a withholding tax on interest income by 1990, massive capital flight caused the law to be canceled after six months. Finally, corporate income tax was reformed by lowering the rate on retained earnings, in response to increased international competition in product market and capital markets. After unification, raising taxes could no longer be avoided. In order to relieve the deficit, a 'solidarity' tax was introduced in 1991, embracing a temporary 7.5 percent surcharge on personal and corporate income tax. VAT increased from 14 to 15 percent. With a reduction of taxes on undistributed profits from 50 to 45 percent and for distributed profits from 36 to 30 percent, the Kohl government hoped to increase the attractiveness of Germany as an international *Standort*. The marginal rate on business income was reduced to 47 percent. It only became apparent in 1995 that

subsequent tax reforms had led to an erosion of the tax base. The unpopular solidarity tax had to be reintroduced. Further erosion of the tax base created an urgent need for another round of tax reforms in 1997. But because tax reform requires the approval of the Bundestag and the Bundesrat, the CDU/CSU/FDP coalition failed to persuade the SPD majority in the Bundesrat to support the government's tax reform proposals.

4.1.6 Record

International competitiveness of the German economy was strong for much of the 1980s. In contrast to the 1970s, however, the level of employment was below the OECD-average. In the wake of the second oil-price shock employment in the exposed sector was virtually stagnant. By contrast, employment in the sheltered service sector grew more rapidly in the 1980s and did not suffer a major setback after unification, whereas employment in the exposed sector experienced a decline. These tendencies ran parallel to low and even narrowing earnings differentials. Manow and Seils convincingly show how German labor market problems are related to the failure to create enough jobs in the sheltered service sector for those laid off in the exposed industries. They forcefully argue that the continental design of German social security policy is at root cause of the German labor market predicament. Germany has experienced modestly rising income inequality since the mid-1980s. In Germany the changes in income distribution largely occurred at the extremes with higher income groups gaining more and lower-income groups falling behind. In recent years there has been an increase in poverty among young families and single parent families, while double income households and the elderly seem to have fared relatively well.

Only very recently has the German problem of external adjustment been recognized in terms of problem of insufficient policy coordination among monetary, fiscal, wage and social policy. The crisis of unification did not persuade policy makers to refashion the prevailing social and economic policy profile in a more coordinated fashion. In effect, the unification induced a 'conservative' policy reflex. As it involved a step into the unknown, it was decided that policy adjustment was to be carried in a manner, which involved as little disturbance as possible to well understood rules of procedure. Now it is generally appreciated the conservative reflex did not suffice. Moreover, as the situation of

divided government has come to end with the election of Red-Green coalition under Schröder, there is today more scope for a effective *Bündnis für Arbeit* (Alliance for Jobs), which link problems of industrial relations, competitiveness, taxes and social policy problem in an encompassing policy package.

4.2 Austria

The unfolding of policy adjustment in Austria followed from an effective 'Austro-Keynesian' response to the first oil-price shock, combining fiscal stimulation and consensual wage moderation. Unemployment was avoided also by lowering labor supply, mainly by sending immigrant workers home. The response to the second oil-price shock was less effective, as high interest rates forced the Austrians to give up fiscal stimulation and monetary reflation. During the mid-1980s Austria embarked on a large-scale restructuring and privatization of its nationalized industries, especially in the metal sector. Finally, in the first half of 1990s, two consolidation packages were adopted, with the support of the social partners, to fulfill the Maastricht criteria. These included a number of adjustments in social security and labor market policy.

4.2.1 Macro-Economic Policy

When Austria faced the first oil-price shock, the socialist government, under Kreisky, was determined to defend full employment. The government basically adhered to a Keynesian diagnosis of the ensuing recession, which was by and large shared by the trade unions, employers' organization and the conservative opposition party. This common understanding of the crisis, helped Austrian policy makers to pursue a common policy strategy, coined 'Austro-Keynesianism'. Expansionary fiscal and monetary policies were deployed to stabilize effective demand and employment. A hard currency policy was adopted as the appropriate instrument to curtail inflation. Finally, the social partners took the responsibility for the competitiveness of Austrian industry by way of a moderate wage policy. The macro-economic performance of the Austrian economy thus compared particularly well with other countries during the stagflation period, owing to the high degree

of coordination between fiscal policy and incomes policy under the shadow of a hard currency policy. While the Austrian strategy was pretty successful in maintaining full employment for most of the 1970s, there was, however, a serious drop in employment. This affected especially immigrant workers, who were sent back home. Export subsidies were used to ease the burden of the hard exchange rate for ailing industries. Since 1976, the Austrian schilling has been tied to the D-mark. Even though this choice has meant a continuous effective appreciation of the schilling, the overall consensus over the strong currency policy was never challenged

The second oil crisis in 1979 hit the Austrian economy much harder than the first. But it did not hurt Austria as hard as Belgium or the Netherlands (see below), in part because of the success of Austrian response to the first oil-price shock. Nevertheless, in the face of high interest rates Austria failed to 'dive through' the second oil crisis. Public deficits made debt servicing a mounting problem. Tax increases were introduced in 1983 but these produced no real relief for Austria. High inflation, low growth and a growing current account deficit had to be paid for by higher interest rates in order to maintain the hard currency policy. An isolated expansionary fiscal policy was no longer tenable. Fiscal consolidation gained priority over full employment, while the stabilizing elements of the model, i.e. the hard currency and moderate incomes policy, were maintained. In the process, the Austrian model lost some of its appeal, though its performance still kept up. In the 1990s, the Austrian economy remained in good shape, while unemployment was much lower than in many other European countries. But the restrictive policy of the German Bundesbank, which led to a strong appreciation of the schilling, and measures to reduce the budget deficits in line with the Maastricht Treaty, dampened effective demand and growth in the first half of the 1990s. Again wage moderation helped to soften the combined effects of hard-currency and expansionary fiscal policy on the balance of payments. After 1995, a strict budget consolidation policy package was adopted to fulfill the entry exam of the EMU.

4.2.2 Wage Policy and Industrial Relations

For the area of industrial relations and wage policy in Austria, it is important to emphasize the extent to which capital and labor shared the same social and economic policy

priorities. It could be argued in this respect that the Austrian pattern of industrial relations escaped the polarizing impact of the resurgence of class conflict after 1968. Moreover, Austrian unions, unlike Swedish or Dutch unions, have never pursued explicit and ambitious distributive goals.
Wage differentials are very high in Austria. In fact, inter-industry wage differentials are the highest in Europe. The introduction of a relatively high minimum wage, only in the late 1980s, has narrowed wage dispersion somewhat. To be sure, full employment has always been considered by all the parties, involved in Austrian corporatism, to be the most effective distributive policy. A moderate incomes policy through a pattern of wage leadership in the metal industry under the shadow of hard currency policy, continued to work quite well throughout the period under study. For the 1970s wage increases were slightly above productivity increases, while in the 1980s wages were set below labor productivity trends.

4.2.3 Industrial policy

Until the 1980s industrial policy was defensive, mainly geared towards helping ailing industries by way of special subsidies. Support was given to the textiles, clothing and leather industry. Large-scale interest-rate subsidies were given to promote private investment. In the late 1970s, when the nationalized industries were still competitive, firms in public ownership employed about 9 per cent of all workers, which amounted to no less than 25 percent of manufacturing employment. In the mid-1980s, the structural crisis in the nationalized iron industry contributed to the problem of unemployment and the public deficit. The reorientation of industrial policy from 'government-led growth' to 'industrial adjustment' ushered a process of restructuring and privatization, with negative implications for employment and growth; growth fell behind while unemployment doubled. After the mid-1980s, industrial employment fell by 17 percent. Subsequently, the large banks were privatized. In retrospect, it could be argued that Austro-Keynesianism helped to conserve old and outdated industries, hampering structural adjustment and technological change. Also the consolidation packages of the mid 1990s were in part financed by the sale of majority stakes in nationalized industries and banks.

4.2.4 Social security policy

Like for many other continental welfare states, the Austrian response to mounting labor market problems in the 1980s and early 1990s was to allow for easy exit through expansion of early retirement and disability pensions. Nevertheless, the rise in inactivity began late, and stayed, at a relatively low level compared to Belgium, the Netherlands, and Germany after unification. In the process, the number of elderly workers fell dramatically and female employment also decreased. Because of this deal between the social partners was expensive for the public sector. After the mid-1980, the government began to follow a policy avenue of incremental retrenchment. Pensions were hit the hardest. The government introduced reductions in transfer payments, a wage freeze for public employees and public pensions, and reductions in public employment. In 1988 new cuts were introduced, while the qualifying period for pensions was raised from 10 to 15 years. Finally, in 1995 the EMU consolidation package implicated cuts in benefits, reductions in social services, the expansion of means testing and qualifying periods, stricter regulation for unemployment benefits and early retirement, and a cap on the health care budget, compensated by minor improvements maternity leave and tax credits for families. Most recently, the pension reforms of 1997 again extended the qualifying period from 15 to 18 years, while pension indexation was suspended for one year. This makes it hard for people with short employment careers to draw a full pension. In social assistance legislation the right to a benefit has been made more contingent on the willingness to work and in case of abuse there will be tough sanctions.

4.2.5 Labor market policy

Active labor market policies play a minor role in Austrian labor market performance, like in many other continental welfare states. Nevertheless, programs of vocational training and education, aimed at the prevention of youth unemployment have been fairly effective. In the 1970's the nationalized industry were effectively hoarding labor. In the second half of the 1970s until the mid-1980s labor market policy preferences focused on the reduction of

working hours. In 1975, a law effecting foreign workers sanctioned the social partners to control the supply of foreign workers, which led to a drastic reduction in foreign workers. After 1983 the discussion about a reduction in working hours and the extension of vacations re-emerged. After the fall of the Berlin wall, Austria suffered from a dramatic supply shock of about 200.000 additional workers, 7% of the labor force. Public employment grew again between 1987 and 1996 by 7%. In 1997, because of continuing budget constraints, a lid was put on public sector hiring. Recently, active labor market policy measures, now under the joint jurisdiction of the social partners, have gained in importance. So far, only small adjustments have been made to change working time regulation. Austria suffers from the least flexible labor time regulation in the European Union.

4.2.6 Tax policy

One element of the successful Austro-Keynesian response to the first oil-price shock was a substantial Increase in VAT on luxury goods, including a 32% VAT on cars. For the rest of the 1970s and 1980s it was quiet in the policy area of taxation. There was a tax reform in 1988, which reduced corporation tax rates, from 55% to 30% (later raised to 34%). In 1989 marginal tax rates and the average level of income taxation were reduced significantly, but progression in income taxes increased. In 1993 asset taxation was abolished altogether. Further reductions are planned to reduce non-wage labor costs for low wage sectors in particular.

4.2.7 Record

Throughout the 1970s, Austria was successful in maintaining full employment. After the recession of the early 1980s open unemployment doubled. Employment fell most dramatically between 1975 and 1985. In the 1990s, despite remarkable economic growth in the first half of the 1990s, the Austrian labor market was not able to absorb the increase in labor supply resulting from the swift increase in female participation and the large in-flow of foreign workers. Registered unemployment figures do not reflect the true nature of

labor market slack. This is especially true for continental welfare states. Overall employment is relatively high in Austria. However, during the last decade, despite massive industrial restructuring and privatization jobs were mainly created in the public sector. Total employment increased by 7 percent, two-thirds of which concerned jobs in the public sector. The very large rise in female participation belies Austria's reputation as a woman unfriendly welfare state. Still, part-time employment is relatively underdeveloped. There was a moderate rise in earnings inequality in a welfare state where wage differentials are generally much larger than in many of the other continental and Scandinavian welfare states in our sample.

4.3 The Netherlands

The sequence of policy adjustment in the Netherlands is best described in terms of four large policy shifts, adopted, respectively, in the jurisdictions of macro-economic policy, wage and industrial relations, social security policy, and finally, the area of labor market policy. The shift to fiscal retrenchment and the commitment to a non-accommodating monetary policy, aligning the guilder to the D-mark, was further tightened towards the end of the decade. This resulted in a loss of competitiveness, a massive increase in unemployment, increasing non-wage labor costs, and rising public deficits. The return to wage moderation was adopted in the early 1980s. A condition of predicament persuaded the social partners and state officials, after a long period of policy stalemate, to resume a concerted strategy of wage restraint in order to recoup corporate profits, investments and jobs. This was followed by a series of adjustments in the area of social security and a major overhaul in the governance structure of the Dutch system of insurance in the early 1990. From the early 1990s onwards, finally, a range of active labor market policies gained currency. These policy shifts were interrelated: they created the conditions and the demands for one another, and neither of the policy changes could have been successful in their own terms in the 'tightly coupled' welfare state of the Netherlands.
Together with product and (?) labor market liberalization and deregulation, fiscal discipline and wage restraint in the Netherlands ultimately paid off in terms of revolutionary job growth in the second half of the 1980s when growth picked up in the world economy. Furthermore, low wages and increased demands for Dutch exports in the new German

Laender helped the Netherlands to successfully wither the global recession of the early 1990s. Domestic economic growth helped to speed up job creation in the sheltered service sectors.

4.3.1 Macro-economic policy

In the aftermath of the first oil-price shock, the labor-led government under Den Uyl pursued an expansionary *macro-economic policy* in an attempt to overcome the dilemma of stagflation. The Dutch government strengthened purchasing power by increasing discretionary public expenditure, which in 1975 accounted for 53 per cent of GDP. Like Austria, and Belgium, the Netherlands responded to the collapse of the monetary system of Bretton Woods, by bringing the guilder in line with the D-mark in the Snake (1972-1973). However, unlike Austria, the social partners, especially the trade unions, were unable to stabilize fiscal expansion through wage moderation. The opposite happened. In the face of an inflationary wage-price spiral, exacerbated by egalitarian indexation mechanisms, wages soared and public expenditure rose sharply as a result of the rapid increase in the number of social security recipients. This reflected both a rise in unemployment and a decline of employment through the use of the social security system for the shedding of older and less productive workers. The Dutch disease further complicated the Dutch policy response as gas exports drove up the exchange rate, with the negative side effects for exports, other than gas, and increased imports, crowding out domestic products. While public and private consumption both rose as a share of GDP, business investment fell considerably in the 1970s. Successive governments felt obliged to intervene a number of times in wage setting procedures. After the mid 1970s, the government gave up its demand-side policies of job creation, which had not produced any positive results.
By the end of the 1970s, rising unemployment, increasing public deficits (almost 9 percent in 1983; according to our figures the public deficit in 1983 amounts to 5.8%: since I have used the ADB figures for the record tables and also for the reason of comparability, we should stay consistent and use them also in the text), declining competitiveness relative to

neighboring countries, especially compared to Germany, and falling growth rates, put the Netherlands in a tight corner before the severe onslaught of the second oil-price shock. When the second oil-price shock hit the Dutch economy, it experienced a more severe recession than any other country in our sample. Real demand suffered a serious decline while unemployment rose dramatically. As real interest rates shot up, following the second oil-price shock, the main policy objective now became fiscal retrenchment. Triggered by the exceptionally severe recession of 1981-82, the inauguration of the center-right coalition government under Lubbers in 1982 acted as major catalyst for policy change. The new government immediate threw its support behind a deflationary macro-economic policy program. After 1982 fiscal policy adopted a more restrictive stance to reduce the 'collective burden', a number of cost-saving measures were introduced in social security. In 1983, the guilder was officially pegged to the D-mark. Anti-inflationary monetary policy and fiscal restraint were pursued throughout the 1980s. By the end of the 1980s fiscal consolidation was achieved. The reduction of the public sector deficit was especially remarkable from 1983 to 1985, with major reductions in the government's wage bill, social security spending and public sector investment. In the first half of the 1980s the large deficits were partly financed by the central bank. This situation changed in 1987 when inflation rates in the Netherlands fell below the German level.

When the economic downturn in 1992/93 threatened once more to aggravate the budget problem, government felt obliged to cut expenditure again and to impose another freeze on social security benefits. As a result of the currency turmoil in the summer of 1992 the effective rate of the guilder rose by over 5 percent. The appreciation against most other currencies was accompanied by a significant decline in interest rates.

4.3.2 Wage policy and industrial relations

In the 1970s, the automatic adjustment of wages to the rising cost of living was introduced. As the attempts by the government to bring about centralized wage moderation failed, it imposed a number of wage freezes measures, sanctioned by the Wage Act of 1970, to contain the wage-price spiral. At first, the restrictive policy shift in the early 1980s pushed up the level of unemployment to a postwar record of almost 14 percent in 1984. The policy shifts toward fiscal retrenchment and a hard currency meant that changes in the international economy had to be answered for by voluntary wage restraint and/or productivity increases. Because of soaring unemployment and declining membership, the Dutch trade union movement was in no position to wage industrial conflict. Instead, after a decade of failed tripartite encounters, the Lubbers coalitions' entry into office was crowned by the now famous 'Wassenaar Accord on the 24th of November 1982. With the Accord, the unions recognized that for high a level of investment, essential for job creation, a higher level of profitability was required. Ever since wage moderation has been an important component of the Dutch adjustment strategy. Often wage settlements did not fully compensate workers even for the effects of inflation. The aim was to improve the profitability of firms, reduce public deficit, and fight open unemployment. In the process, Dutch wage setting underwent a transition from a highly centralized incomes-policy-based system in the 1970s, to a system dominated by industry-level bargaining, and this transition was followed by a shift to a more non-accommodating monetary regime anchored to the D-mark. Under the restoration of Dutch competitiveness, unit wage costs declined significantly. Unemployment rates were eventually cut by half.

The return to wage restraint contributed to job growth in three ways. First by helping to restore profitability of business it created a necessary condition for investment and job growth. Second, it contributed to the growth of exports. Third, it helped to keep more people on the payroll. As a corollary, labor productivity per hour, although very high by international standards, increased less than in other countries. Estimations of the Central Planning Bureau argue that over 40 percent of Dutch job creation in the last fifteen years must be contributed to the policy of wage moderation. Over time there is shift in emphasis with respect to wage moderation. At Wassenaar wage moderation was traded against a

modest reduction in annual and weekly working hours. With the passing of time, wage restraint was compensated by lower taxes and social insurance contributions, made possible by fiscal consolidation. This helped to maintain spending and boosted domestic demand in the first half of the 1990s. The avenue of substantially reducing the working week was continued by encouraging part-time, endorsed by the social partners. In the 1990s, the successful policy of wage restraint had to be continued because of the devaluations of the Italian lire, the Swedish krona and the British pound in the first half of the 1990s. The long period of wage moderation in the 1980s and 1990s had resulted in a strong competitive position by the early 1990s. Exports continued to increase much faster than the European average, while the downturn of 1992/93 was not as disastrous as in other European countries, again because of a swift response of the trade union and employers to agree to wage restraint. The labor market developed more favorably than elsewhere in our sample. By 1998 the rate unemployment fell under 5 percent.

4.3.3 Social security policy

Given the intimate ties between sectoral bargaining, the breadwinner principle and payroll social insurance provision, it should come as no surprise that, already during the 1970s, the Dutch welfare state embarked on a large-scale strategy of labor shedding in response to industrial restructuring. This policy strategy to subsidize the exit of elderly, less productive workers, and encourage non-entry of women, was continued in the 1980s. Especially, the generous disability scheme and early retirement facilities became popular provisions for reducing labor supply. By the late 1980s, it became obvious that the Dutch welfare state, despite economic recovery, was trapped in a vicious cycle of 'welfare without work'. A cautious policy of cuts was inaugurated in the mid-1980s. After 1983, the link was cut between the level of certain benefits and the minimum wage on the one side and average growth of wages in private sector on the other. Subsequently, a freeze was imposed on the minimum wage after it had been reduced by 3 percent. However, the freezing of benefits in 1983 and an overhaul of the unemployment insurance scheme in 1987 could not halt the crisis of inactivity. After, in 1989, Lubbers in his third term, proclaimed the Netherlands a

'sick' country, the government was able to introduce cuts and more radical measures to discourage the improper use of social insurance and close off some of the 'velvet' exit routed. More recently, the left-liberal government, under Kok, introduced far-reaching institutional reforms in the system of social security, setting the stage for a partial privatization of sickness insurance and disability insurance administration, while the strengthening the role of the state in the system at the expense of the social partners.

4.3.4 Labour market policy

Successive changes in macro-economic policy, wage policy and industrial relations, and social policy, coincided with general shift in the problem definition of the crisis of the Dutch welfare state. In the 1990s, as a result of this learning effect, Dutch labor market priorities underwent a U-turn. The overarching policy objective was no longer to keep overt unemployment down by channeling people into social security system. Instead, the Scandinavian preoccupation with maximizing the rate of labor force participation has become number one priority. The left-liberal government's slogan of 'jobs, jobs, and more jobs' is implemented through the fiscal support of wage moderation by means of a reduction of social contributions for employers and tax incentives for the unemployed, in particular at or near the minimum wage. Public employment agencies have reformed on a regional and tripartite basis. Temporary wage subsidies and job experience programs have been introduced to provide work experience and to further the participation of people who have poor chances in the labor market. Activation clauses are introduced in social assistance and unemployment insurance. The general flexibility in labor time increased. As a result, part-time work has acquired great importance in the Netherlands in the last ten years. There have been numerous programs to deal with unemployment, route placement etc. Most of these programs provided training, work experience, motivation and a chance of making a transition to a permanent job. Alongside labor market policy changes, important product market reforms have been introduced, ranging from a general prohibition of price fixing, a new Competition Law, liberalization of business licensing requirements, liberalization of shop opening hours, privatization of postal and telephone services.

4.3.5 Record

The Dutch economy has made considerable progress since the early 1980s. Most economic indicators look relatively good: a high standard of living, a generous social security system, stable currency and a solid trade balance, and positive employment record. After having fallen to the lowest employment ratio in all countries in our sample (50.8 percent) in 1984, employment increased steadily to the ratio of 59.9 percent in 1997 – still below the OECD-18 average. Employment growth included a major increase in women's participation. Due to various measures the gross real minimum wage declined substantially and by 1996 was 22 percent lower than in 1979, real youth minimum wages declined even by 46 percent. As a consequence, income inequality has risen since the mid-1980s (astonishingly, this is not the case in the lower half of the earnings scale, where the falling minimum wage should have led to a higher wage dispersion. How would you explain that?). The changes in income distribution have largely occurred at the extremes and higher-income groups have gained while lower-income groups have fallen behind. Due to its linkage to the minimum wage, the gross minimum social benefit declined in real terms by more than 20 percent. Over the past decades, there emerged a new mix of macro-economic policy, wage policy, social security and labor market policy. Fiscal policy is oriented towards stabilizing the business cycle, monetary policy towards a set exchange rate (vis-à-vis the D-mark), incomes policy towards wage moderation, social security and labor market policy and regulation towards raising employment opportunities for both men and women, with a strong emphasis on part-time work. The successful strategy of wage moderation fostered over time a positive interplay between different policy areas, under favorable institutional conditions, which allowed a high degree of policy coordination across time. Initiatives in the area of industrial policy subsided, throughout the period under study, because of the outright failure to save the Dutch shipbuilding industry in the 1970s.

4.4 Belgium

In the 1970s Belgium witnessed one of the sharpest rises in unemployment in the OECD area. Between 1973 and 1983 employment in manufacturing

fell by almost 30 percent. Mass unemployment, low growth, spiraling inflation, rising budget deficits and a severe balance of payments problem, were compounded by domestic political problems which made it extremely difficult for Belgian policy makers to define, adopt and implement appropriate policy responses over the past three decades. Like the Netherlands, Belgium opted for fiscal reflation under the shadow of a hard currency option in response to international monetary crisis and the first oil price-shock. This policy mix proved ineffective as the social partners failed to organize wage restraint and budgetary austerity. Throughout the 1970s and 1980s, in order to keep open unemployment at bay, Belgian social policy was deployed to reduce of labor supply. The policy mix against second oil crisis again revolved around a hard currency option, after a significant devaluation. Wage moderation in the 1980s was forced on the social partners by the government through special enabling laws, suspending free collective bargaining. While a broad consensus over a successful policy of protracted wage restraint in the Netherlands, in the 1980s allowed the government to restructure Dutch social security, in Belgium there was no consensus over wage restraint and the recovery in the 1980s was less robust than in the Netherlands. The lack of consensus in Belgian industrial relations placed far greater demands on the Belgian political system. But the Belgian state was being weakened by the process of federalization. Multi-party negotiation of federalization disabled Belgian policy makers to reverse the pathological cycle of 'welfare without work' in the policy areas of social security and labor market regulation.

4.4.1 Macro-economic policy

After the fall of the system of Bretton Woods, Belgian entered the Snake. Together with the Netherlands, Belgium stayed put after Italy, France, the UK and Denmark deflected. This meant that the Belgian franc and Dutch guilder appreciated against many of the currencies of their competitors, and thus led to a loss of competitiveness. As one of the most open economies in our sample, Belgium was extremely vulnerable for imported inflation. Moreover, with one of the most rigidified systems of wage indexation, imported inflation was exacerbated by built-in stabilizers, which prevented Belgium from developing an effective response to the problem of stagflation. The spillover effect of spiraling inflation through the indexation mechanisms gave Belgian macro-economic policy makers little choice but to squeeze (imported) inflation through a hard currency policy, with the result of a massive fall in effective demand and employment. In the wake of the first oil-price shock the policy of fiscal reflation focused on bailing out crisis sectors and on expanding the public sector. Public employment increased with 35.5 percent between 1970 and 1985. This saddled the Belgian economy with a huge public debt, which continuously increased from 5 percent in 1975 Belgium to 12.7 percent in 1981. As a result, in the 1980s, Belgium spent more than any other country in our sample on debt serving.

The Belgian economy was in a particularly bad shape when it faced the second oil-price shock. After a devaluation of the BEF by 8.5 percent against the D-mark, negotiated with in the Ecofin, the authorities continued to maintain a fixed exchange rate policy. A larger devaluation would have probably brought more relief, but was.vetoed by Germany and the Netherlands. Belgium had to abide by an over-ambitious monetary policy. In the fight against inflation it was successful, but at very high real interest rates, Belgian competitiveness worsened substantially. The public deficit rose to 13 percent, with 20 percent of GDP (in our figures the maximum is 10.1%!) was spent on debt serving of general. Unemployment soared after 1981. In the second half of the 1980s, in spite of a strong recovery of the exposed sectors, the sheltered sectors remained depressed. This is in contrast to the Netherlands where extra demand encouraged a rise in service sector employment in the same period. In the early 1990s more energy is put into fiscal consolidation. The 1992 Convergence plan adopted a specific targets for the reduction of public deficit from 7 to 3 percent in 1997, which was successful. For most of the 1990s Belgium had to run a primary surplus of around 6 percent of GDP in order to serve (and

lower) the massive debt ratio. After the recession of the early 1990s, the Belgian economy again recovered, but labor market performance improved only marginally.

4.4.2 Industrial relations

Between 1968 and 1973 the radicalization of the Belgian trade union movement resulted in a marked increase in strike activity. Under conditions of the resurgence of class conflict, relations between trade union and employers' associations were postwar low. Particularly problematic was the widespread disagreement over the wage setting system. Especially the far-reaching system of wage indexation, designed to protect workers from imported inflation, began to feed on itself with the rising wage claims. The result was an unparalleled price-wage spiral. Indexation thus prevented Belgian social partners and the government from developing an adequate response to the predicament of stagflation in the 1970s. To be sure, in the face of high inflation any attempt to trample on indexation met with stiff resistance from the trade unions. Moreover, indexation served the egalitarian objective of the unions as they helped to defend solidarity between the low and high paid. Like the Dutch governments in the 1970s, the Belgian government therefore sought to gain wage concessions from the unions in the fight against inflation and rising wage costs, without daring to touch the automatic stabilizers, in return for improvements in social security and the extension of early retirement to hide open unemployment.

In the wake of the second oil crisis, after many failed tripartite encounters, the successive Martens-governments placed the social partners under 'preventive custody' for a good part of the decade, on the basis of so-called 'enabling powers', which allowed the government suspend free collective bargaining altogether. Wages were kept under control and wage indexation was partially suspended. This form of imposed wage restraint, however necessary to achieve nominal stability, implied that wage differentials continued to narrow. In the years of free collective bargaining running until 1980 and from 1988 to 1992, wage increases again outpaced productivity increases, and wage bargainers showed little responsiveness to the external (supply) shocks and high structural unemployment. In the mid-1980s, this no-nonsense strategy (what exactly do you mean

here?), accompanied by reductions in corporate taxes, bore fruits. In 1985, the minimum wage for the young was lowered together with unemployment benefits, while waiting days were extended. Schemes to create more jobs, however, met with limited success. There was agreement over 5 percent reduction in working hours, on the basis of a 3 percent wage sacrifice, and a 3 percent increase in hiring. Preventive custody extended to the late 1980, to be replaced by the law to safeguard competitiveness in 1989. This special 'competitiveness' law established an explicit wage norm: Belgian wages should not rise more than the average trend among seven major trading partners.

4.4.3 Social security

The first oil-crisis speeded up the decline of heavy manufacturing, especially in the steel sector in Wallonia. The Belgium response to industrial decline, already in the 1970s, followed the continental trajectory of welfare without work. Most resources were spent on fairly generous welfare measures, like early retirement, which was introduced in 1976 and extended in 1982. In 1982 to 3 percent of workforce was on early retirement, which essentially added up to 50 percent of the target group. In 1977 a ceiling was placed on earnings-related benefits, however, with no time limit, under the unemployment insurance scheme. Administration remained under the control of the social partners, with significant local union involvement. When policy makers opened the door to early retirement in 1976, there was a rapid decline in employment among males in the age group of 55 to 64. Other measures included the requirement to take on trainees in exchange for a reduction of employers' social security contributions. In the 1980s early retirement schemes expanded with supplementary benefits for firms who replaced redundant workers by younger workers. Early retirement age threshold was subsequently reduced from 58 to 55 years, and the special subsidies to employers who hire younger unemployed workers were extended. In the 1980s the export sector could only stay competitive by way of above average productivity growth. With respect to labor productivity, Belgium ranked in 1980, with the Netherlands directly after the US and Japan, before Germany and France. The combination of real wage growth, rising non-wage labor costs and a strong external constraint, explains the basic Belgian policy choice to lower the input of work. Long-term

unemployment hit workers with low skills, immigrant workers and their offspring particularly hard. In 1990s, the operations offering reduction of social security contributions and non-wage labor costs, between 10 to 15 percent, for youth and long-term unemployed are extended many times. In the area of social services, health care, education, and family services, there has been in the 1980s a trend towards federalization. This has contributed to the already existent imbalance in fiscal policy, as the regions and communes take up 40 percent of the assets and only 6 percent of liabilities. The federalization process essentially curtailed the room of fiscal retrenchment. More recently, the growing tensions between regions, even reflected within the parties, the trade union and the employers organizations of the same ideological families, plays an important factor in the apparent stalemate in social security reform. In Flanders a widely shared preference is emerging with respect to a regionalization of social security. The stumbling block, of course, is how much Flandres is willing pay into national debt in exchange for the federalization of social security.

4.4.4 Labor market policy

Belgium was probably the first country to help unions negotiate a deal to lower the working week to 39 hours, as early as 1977. The money spend on active labor market policies (although higher than in Austria and Netherlands) is used rather ineffectively and inefficiently and has so far had no positive effect on structural unemployment. In 1994 more labor market flexibility is introduced through a number of measures. The ban of successive temporary contracts is relaxed, shorter notification periods are introduced, and local employment services have expanded their activities in the third sector. The social partners continue to favor the reduction of working time in the fight against unemployment. Belgian trade union and employers are generally against part-time work. The government is currently contemplating improved rights for leave of absence, a right to part-time retirement, together with a further lowering of social security contributions.

4.4.5 Record

(INCOMPLETE)

Wage compression has gone to extremes in Belgium; only in Scandinavian countries the D5/D1 ratio is smaller. Belgium is one of the few countries where there has been a trend towards less earning equality. Unemployment remains high and the employment ration is one of the lowest in the OECD area. Depressed domestic demand. Belgium has experienced modestly rising income inequality since the mid-1980s. In Belgium the largest losses in income shares occurred around the median for the three middle-income quintiles from the mid-1980s onwards. The number of households with zero reported income is particularly large in Belgium.

4.5 Switzerland

Switzerland stands out as the most robust country in our sample. It is now, as it was already in the 1970s, characterized by liberal financial markets, low taxes, a flexible labor-market and a lean welfare state. Before 1970s, Switzerland had a very high per-capita income and it enjoyed very high levels of employment. Unemployment was non-existent. The low tax burden matched the low expenditure level of the underdeveloped Swiss welfare state, which merely offered protection to the working male population. Foreign workers and women were largely excluded from the Swiss welfare system.

The difficulties of economic internationalization, if any, came late for Switzerland, in the 1990s. The international recession of the early 1990s were exacerbated by a number of changes in the Swiss social and economic policy repertoire, which were adopted during the 1980. First, the buffer function of unprotected foreign workers and women disappeared. Many foreign workers received more permanent working contracts and residence permits and women became to unemployment benefits. Secondly, lenient and generous lending criteria and protective measures created a condition of over-capacity, especially in the construction sector. This became a serious economic policy problem in the 1990s when a number of protective measures were removed and competition in the financial sector intensified.

The Swiss condition of minor predicament in the early 1990s stimulated a series of responses in the policy areas of tax policy, industrial policy, labor-market policy and social

policy. These adjustments have not altered the Swiss model much but they do reveal that even Switzerland has become more constrained internationally in its policy choices.

4.5.1 Macro-economic policy

Switzerland never experimented with any kind of Keynesian macro-economic management. Monetary and wage policies were never coordinated and the Swiss financial markets have always been highly deregulated. When other countries had to abandon their traditional macro-economic policy measures, in the wake of the multifold recessions of the 1970s and early 1980s, Switzerland was more or less unaffected by the international turmoil and could easily stabilize its position in the international economy. As a result, Switzerland held on to relatively low interest rates. The slow increase in employment, achieved after a deep fall in the mid-1970s, was not negatively affected by the swings of monetary and fiscal policy elsewhere. As a consequence, Swiss cumulative employment increases between 1979 and 1985 were higher than in any other country in our sample. In effect, low and even negative interest rates during the 1980s, together with liberal and generous lending criteria, created a boom in the construction industry. The boom fell apart in the early 1990s, in the wake of German unification, when property prices dropped, following the international downturn, and Swiss banks tightened their lending criteria. As a consequence, there were numerous bankruptcies in construction with an immediate negative effect on employment performance. The swift rise in unemployment up to four percent also created a deficit in the unemployment funds.

4.5.2 Tax policy

The priorities of Swiss tax and fiscal policy are geared towards low taxes and a balanced public budget. When public budget turned negative for the first time after 1992, the Swiss swiftly introduced a value added tax (VAT) - a policy novelty for the Swiss. In response to the introduction of VAT, the business community pressed for compensatory measures. With the restructuring of the tax rate in 1997, the tax rates on corporate and capital income have come down, making Switzerland's rates among the lowest in the OECD-

area. The revenue loss from the reduced rates will be compensated for by not yet specified expenditure reductions in other areas as part and parcel of a fiscal 'Consolidation Plan', which the Swiss parliament adopted in 1997.

4.5.3 Industrial policy

Despite the restrictive monetary policy followed by the central bank and appreciation of the Swiss franc, Swiss export industries have performed well throughout the period under study. This is due to two factors. First, Swiss exports have always been highly specialized, competing in niche markets. Second, reductions in the profit margins for a number of large companies together with removal of barriers to trade, since the 1980s, seem to have provided the right incentives for effective strategies of industrial restructuring, rationalization, outsourcing and lean production to increased competition in product markets. Competitive pressures were subsequently passed onto the sheltered sectors in the 1990s, which forced them to accept cost-reductions. Subsequently, policy makers launched of package of liberalization and deregulation in the sheltered sector. In the early 1990s, the export industries pressed for further deregulation, liberalization and cutbacks in several other areas of the Swiss labor market and social security policy.

4.5.4 Wage policy and industrial relations

Switzerland has generally been characterized by a consensual but rather decentralized system of industrial relations. For much of the 1980s, the social partners were able to reach an agreement over wage moderation, which together with the expansion in the financial sector brought Switzerland swiftly back to full employment. In the 1990s, in the wake of the recession and the intensification of international competition, the employers in export industries pressed for a radical decentralization of the wage setting system down to the firm level. Their successful campaign for decentralization led to the cancellation of the right of employees to a thirteenth month's salary. Depleted of any form of organized wage moderation, wages are in line with inflation.

4.5.5 Social policy and labor-market policy

The response of Switzerland to industrial decline in the 1970s followed the continental policy routine of shedding labor and discouraging women from working. In Switzerland, unlike Germany, the Netherlands and Belgium, this exit strategy did not burden the system of social security, as the groups, immigrants and women, were originally not protected by the Swiss social security system. The large population of foreigners worked on insecure and temporary working contracts, lacked secure residence permits, and were thus forced to repatriate to Italy and Spain. Working women were also not entitled to unemployment benefits. When the first oil-price hurt Swiss industries, these two groups provided for an important buffer. The core endogenous male workforce was largely unaffected by the initial economic downturns. Neither did the crisis affect the lean - or should we say mean - Swiss welfare state.

During the 1980s, Switzerland more or less gave up on the buffer of foreign workers and women. Many of the insecure work permits in use in the 1970s and early 1980s were gradually converted into permanent residence permits. Second, there materialized a change in mentality and attitudes towards female employment. Female work is no longer seen as an accessory occupation, and also the availability of unemployment benefits was extended to women and foreign workers. The likelihood of a swift and large withdrawal of women and foreigners from the labor force in the case of an economic crisis was reduced accordingly. With institutionalization of rights of protection for women and foreign workers, the more inclusive, but still lean Swiss welfare state became more vulnerable to vicissitudes of the international economy. This increased vulnerability showed became apparent in the early 1990s with the rise in unemployment and an increasing budget deficit in Switzerland.

4.5.6 Record

By the end of the 1990s, Switzerland still is the richest among the rich countries in our sample. It has the highest per-capita income and the highest levels of employment in the OECD. Unemployment exists, but is low compared to all other continental welfare states. Meanwhile, social protection has been increased and broadened and, apparently, wage

inequality has not been affected by the changes in wage setting. Over the past twenty years, the Swiss employment performance is the best in our sample. Although in the process Switzerland suffered a dramatic loss of employment in manufacturing, employment in the domestic service sector seem to have able to make up for the job losses in industry. In Switzerland income inequality has been modestly increasing since the mid-1980s

5 France and Italy

France and Italy defy easy classification. The French state is more activist than the Italian, while Italian civil society is more encompassing than its fragmented French counterpart. In term social and economic policy content there are, however, more similarities than differences. Macro-economic policy in France and Italy conclusively lies within the jurisdiction of the state. There is no lengthy tradition of independent central banking. Both France and Italy have large public sectors (this is not reflected for I in our figures!). Industrial policy is highly interventionist in France and in both countries there is, historically, a large nationalized sector of banks and industries to compensate for the lack of private capital. In the shadow of state-controlled conglomerates, there is a sizable sector of small and medium-sized firms in both countries. The systems of industrial relations in France and Italy are highly politicized, which is paralleled by a tradition of state intervention in the resolution of 'wildcat' strikes, especially in the public sector. French unions, rejected by management, only organize a small proportion of the work force. Likewise, there are no institutions of social partnership. In Italy, with better organized trade unions, there is more room for corporatist encounters between the state, the employers and the trade unions.

With respect to social policy, the French and Italian social security systems largely follow the continental model of transfer-oriented, payroll financed, system of social insurance. They differ, in comparison to Germany, Austria, Belgium and the Netherlands, with respect to large numbers of people who not covered by the social security system. Social protection in France and Italy is more skewed in favor of insider groups in the labor market than in the other continental welfare states. An older generation of industrial workers belonging to the primary labor market is rather well-protected, while younger and female

cohorts with atypical contracts remain relatively underfunded and underprotected. In Italy, the polarized system of social protection, moreover, has also a strong territorial component, between the rich and industrialized Northern regions and the poor and underdeveloped *Mezzogiorno* in the South. For most of postwar period, clientelism reinforced the high degree of labor market segmentation and social protection dualism. In both France and Italy, the insider-outsider cleavage is reinforced, like many other continental welfare states, because the administration of the social security funds is largely in the hands of the social partners.

The labor markets of France and Italy are highly regulated, and like in the continental welfare states, there was, until recently, little interest in active labor market policies, more so in France than in Italy. The level of employment varies between 50 and 60 percent, in Italy with extremely low levels of female participation.

5.1 France

The French experience of policy adjustment is best told as a very painful learning process, imposed by international economic constraints, and one without a happy ending. The unfolding of events emanated from an inflationary growth strategy in response to the first oil-price shock and, subsequently, a failed move towards fiscal retrenchment in the late 1970s. In 1981, when the socialists came into power, Mitterrand launched a radical left alternative policy strategy to address the recession of the early 1980s, which included a traditional Keynesian policy package of increased public and private consumption, devaluations, together with a large scale nationalization program. An immanent monetary crisis in 1983 forced the French socialists to make a complete policy U-turn from Keynesianism *programme commune* to the policy strategy of *désinflation compétitive. This* orthodox strategy of monetary stability, wage restraint, and fiscal retrenchment, to correct the severe imbalance in macro-economic. The new macro-economic policy strategy of *désinflation compétitive* served to dismantle dirigism in French industrial policy. But while inflation subsided, unemployment kept rising and employment fell dramatically. In part to undercut resistance to economic liberalization, the French socialists expanded the welfare state to protect workers from dislocation. By doing so the welfare state and labor market

policy reforms became implicated in the French reform strategy, however, to no avail. Employment continued to decline and unemployment rose further to levels over 11 percent.

5.1.1 Macro-economic policy

In the first half of the 1970s, France pursued an inflationary growth strategy with a soft monetary and fiscal policy to stimulate the economy. Between 1978 and 1981, under Giscard d'Estaing, the first steps towards fiscal retrenchment were taken. As the neoliberal policy program failed to bring relief, in 1981, the socialists, with the election of Mitterrand, decided to adopt an alternative macro-economic policy strategy. The diagnosis of the crisis among Mitterrand's policy advisors was distinctly Keynesian: the rise of unemployment was the result of a decline in effective demand, a problem that could only be dealt with by a boost in private and public consumption and investment. The expansionary policy package included a rise in the minimum wage by over 10 percent, additional openings in public sector, two devaluations of the franc, and a large-scale nationalization program of French banks and industries. The policy strategy of an isolated Keynesian experiment in the midst of a low growth restrictive international economic environment, failed miserably. Unemployment kept growing. Triggered by an acute currency crisis, the French socialists made a complete U-turn in 1983. The *programme commune* was traded for a policy strategy that was later coined *désinflation compétitive.* In order to avoid further speculation, a third exchange-rate adjustment was necessary. The paradigm shift to *désinflation compétitive* signaled the demise of Keynesian economics on the European continent. The policy of competitive disinflation relied on three economic principles: growth must be export-led, exports require competitiveness, and competitiveness requires downwardly flexible wages and prices. Central to the strategy of *désinflation compétitive* was the *franc fort.* By pegging the franc to the D-mark, monetary policy makers hoped to contain inflation, foster wage discipline, which could, in turn, lead to lower interest rates. Public deficit reduction completed the strategy of competitive disinflation. At the end of the 1980s, *désinflation compétitive* was firmly rooted in French macroeconomic policy, but did not receive international credibility. Interest rates were not

brought down far enough for a healthy recovery of the French economy. The economic recession of the early 1990s, moreover, prevented French rates of unemployment from gradually overcoming the effects of the long period of disinflation since the early 1980s. The EMS crisis overshadowed by a deep recession pushed France further down the path of low growth and high (structural) employment. Again, French monetary authorities decided to raise real interest rates. A tight money policy and fiscal consolidation were required for the purpose of making sure that France qualified for EMU.

5.1.2 Industrial policy

Part of Mitterrand's *programme commune* of 1981 included the nationalization of 36 banks and 11 large industrial conglomerates. The aim to create 'national champions' was in full agreement with generalized French tradition and perception that the state can run capitalism better than the capitalists. But again the ambitious industrial policy strategy of 'competitiveness through nationalization' was wholly ineffective at selecting the right winners for international competitiveness. With the conversion towards *désinflation compétitive*, interventionist principles were abandoned. Many of the nationalized industries were again privatized in the course of the 1990s. The paradigm shift in economic policy is also reflected in the shift in emphasis towards more defensive emergency measures. Moreover, the *franc fort* came to put a severe market-constraint on internationally competitive firms to modernize and rationalize. A number of French economists argue that because of the obsession with wage and price discipline in the *désinflation compétitive* paradigm, France failed transform its economy towards a high wage, high quality *Rheinish* model. This may be true, but the old statist alternative was so massively discredited, that there really was no other option than to lift credit, price, and capital controls in a market-making exercise. Moreover, France lacks the institutional preconditions to create a negotiating economy.

5.1.3 Wage policy and industrial relations

Wage restraint was another pillar of the competitive disinflation policy strategy of French socialists after 1983. French macro-economic policy makers hoped that the conversion to

a tight money policy would encourage the trade unions to change their collective bargaining strategies and to shift to wage moderation, like their counterparts in Austria, the Netherlands and Germany. French trade unions and employers' organizations, however, lacked the kind of encompassing organizations and joint structures of social partnership to support a long-term negotiated agreement over competitive wage adjustment. Because they do not even share the same diagnosis of economic problems, the government's policies of wage moderation and fiscal consolidation have been less effective than elsewhere as they faced various waves of industrial strife, especially in the public sector. In 1983, the French government canceled the wage indexation mechanisms. French unions really have had to learn the hard way. In the face two-digit levels of unemployment, the weak trade unions of the private sector were in no position to wage industrial conflict. In the event, brutal unemployment guaranteed wage discipline. Recently, the Jospin government, which came to power in 1997, is advocating reversing the lack of intermediary institutions in the French economy, and to create culture 'bargaining and compromise' and establish cooperative industrial relations. One of the more promising institutional changes in this respect is the institutionalization of a 'Wage and Employment Conference', bringing together organized capital and labor, in an attempt to create the necessary preconditions for policy coordination between wage setting and macro-economic policy. Only time will tell whether Jospin will be successful. But it needs to be repeated that in French industrial relations there is no tradition of public-regarding collective action to build on.

5.1.4 Social security policy

The discontinuation of the ambitious French industrial policy program after 1983 led to a massive loss of jobs. This of course had severe consequences for the French system of social security. Consistent with responses in other continental welfare states the French reflex to industrial decline was to establish so-called 'conversion pools', again with heavy state subsidies, which allowed for early retirement on a full pension at the age of fifty. As a consequence, in the 1980s, France experienced the sharpest decline of any OECD country in the participation rates of males between the ages of 55 and 64 as well as the

largest loss of employment in the exposed sector. Levy argues that the expansion of early retirement programs in declining industrial regions were in fact needed to stave off social conflict and worker resistance to industrial restructuring. In the late 1980s and early 1990s, there is again a change in focus as costs begin to soar. With the introduction of a guaranteed minimum income and employment subsidies, initiatives to help re-integrate unemployed youths and the long-term unemployed in the labor market gained prominence, and point towards more 'employment friendly' social policy initiatives, especially for the young. For the rest of the workforce, France continues to suffer from the 'continental dilemma'. Generous minimum wages and high non-wage labor costs continue to frustrate the creation of the kinds of low-skill, low-productivity jobs that are needed to bring down unemployment. High unemployment, high levels of subsidized non-employment, low levels of employment continue to incur chronic deficits in the social insurance funds.

In 1988 Balladur was able to curtail the generosity of the pension schemes for the private sector by shifting the calculation of reference salary from the average of the best ten years to the average of the best 25 years of a workers career. The pension reform also required a minimum of 40 years before retiring, as opposed to 37.5 years before. Balladur also increased social security taxes. After Balladur, Rocard introduced a new social security tax, which in contrast to social security contribution is imposed on all earnings, including capital and property. In the next round of reforms, Juppé proposed to extend the changes in the pension introduced by Balladur to the public sector. He was especially bent on eliminating the special measures, which allowed public employees to retire at 50. The response to the Juppé plan was a six-week strike that paralyzed the country and incurred a substantial loss on the economy. Juppé was forced to back down on his pension reform proposal. Other measures for cost-reduction, such as freezing of family benefits in 1996, and the plans to make them taxable in 1997 were more successful.

Perhaps the most important reform that Juppé was able to realize involved a substantial change in policy content and governance structure in French social security. There has been partial shift from financing, away from contributions to towards the use of taxation in the health care system. Even more important changes in the *Ordnungspolitik* in French social policy were realized through the constitutional amendment that allowed Parliament

to vote on the social security budget; and a change in the administration of the social security funds, whereby state officials gained influence at the cost of the social partners. As such, Bonoli and Palier argue, the Juppé plan, involved a major re-structuring of French social security. This change in the governance structure and policy content signals a gradual transformation from a largely Bismarckian to a more Beveridgean, tax-financed and state-run, system of social security; a change that is difficult to reverse.
Jospin was elected on the promise of a more equitable and fair approach towards welfare retrenchment. He eliminated the allowances to the more well to do families and abandoned the introduction of means testing. In 1998 corporate taxes were slightly increased. The Jospin government also supported creation of private pension funds, to be managed collectively by employer and union organizations, as a complement to the French PAYG system.

5.1.5 Labor market policy

As a consequence of massive increases in social security contributions to finance the growing number of persons receiving unemployment and early-retirement benefits, the French socialists were in no position to launch an expensive active labor market policy in the 1980s. A minor reductions in working hours (from 40 to 39 hours with full wage compensation), and additional job creation in the public sector were unable to reverse job-losses. In the second half of the 1980s and the first half of the 1990, French labor markets were substantially deregulated. There has been a lifting of restrictions on hiring and firing. This has led the proliferation of flexible contracts and part-time work. One sixth of all jobs in France are now part-time. Rocard was able expand training programs and subsidies for hard to place youths and the long-term unemployed. With the election of Jospin, the issue of the reduction of working time is back on the policy agenda. After the aborted attempt in 1981 to go from 40 to 39 hours, Jospin's aim is to reduce the working week to 35 hours by the year 2000. The government is offering significant subsidies (reaching 15 percent of worker salaries) for agreements signed between workers and employers to reduce working hours that result in the creation of 'preservation' jobs.

5.1.6 Record

Unemployment gradually increased to a relatively high level of more than 10 percent and essentially stayed at that level since the late 1980s. Concurrently, French levels of employment declined from just about the OECD-18 average to well below. The large-scale nationalization of industrial conglomerates produced no long-term positive effect on French employment performance. Exposed sector employment displayed a very rapid decline that was not compensated for by job growth in the domestic service sectors. These negative trends were exacerbated during the recession of the early 1990s when macro-economic policy remained highly restrictive. Macro-economic policy succeeded in curtailing inflation, but was less successful in bringing down real interest rates and thus drove France onto a path of slow growth, insufficient demand, high unemployment, and declining employment. In the process France moved from a modest decrease to a modest rise in income inequality. In France the largest losses in income shares occurred around the median for the three middle-income quintiles from the mid-1980s onwards.

5.2 Italy

It was only in the 1990s, pressed by the impending Maastricht entry exam and the growing pressure from international financial markets, that Italian policy makers were able to turn a vicious cycle of industrial decline, budgetary crises, welfare without work for some and poverty for many, into a virtuous policy strategy of the *resanamento* of the Italian economy and its welfare state. In the early 1990s Italy's entry into EMU seemed highly unlikely. The quick succession of reforms, implemented between 1992 and 1998, included a path-breaking budgetary reform, a successful devaluation of the lira, the abolishment of wage indexation mechanisms, agreed to by the social partners, the reorganization of collective bargaining procedures, the decentralization and deregulation of labor market policy from the state to the regions and private intermediaries, the privatization of state owned industries and banks, and an important reform of the pension system, on the basis of a new defined-contribution formula. Together the reforms constituted, as Ferrera and Gualmini argue, a 'quality jump' in Italian political history. Crucial in their analysis is that the *resanamento* of Italian social and economic policy making coincided with a turnover in

the Italian political system from the First to the Second Republic. The political transformation allowed for the much needed autonomy of the Amato, Ciampi, and Dini governments, which in turn were able to encourage the resurgence of a responsive form of policy concertation between the state and the trade unions and employers' associations. For all the actors involved, EMU constituted the foremost catalyst for cooperative policy adjustment in the 1990s. Moreover, the problem of rising unemployment together with the new predicament of decreasing employment and the further widening of a gap in growth, income and employment between the North and the South added to a general sense of urgency, which triggered an impressive series of much needed policy changes.

5.2.1 Macro-economic policy

After the collapse of the monetary regime of Bretton Woods, which unleashed strong speculative attacks on the lira, the Italian currency was devalued in 1973. The devaluation exacerbated already spiraling inflation, reaching a postwar record at 19 percent in 1974. The introduction of the *scala mobile* (literally rolling stairs) wage indexation system in 1975 reinforced the vicious cycle of self-sustaining inflationary expectations. The first oil-price shock brought Italy into a recession, with a drop of 4 percent in GDP. Fiscal policy largely determined monetary conditions. At the end of 1975 the government lowered interests rates, but a new speculative attack caused another large devaluation. Excessive budget deficits forced the Banca d'Italia to give in. This time the devaluation did bring relief: between 1976 and 1979, the expansionary macro-economic policy and the strong depreciation served to sustain Italian competitiveness. But the recovery, based on a stop-and-go monetary policy, was fragile and of short duration. Unemployment continued to rise, especially in the *Mezzogiorno.* By 1981, the vicious cycle of spillovers between devaluation, inflation and indexation, brought the rate of inflation up to 21 percent by 1980, while the public debt reached a level of 68,1 percent of GDP. The entry into the EMS in 1979 enabled monetary policy makers to pursue a more rigorous policy of currency stability and disinflation. Banca d'Italia became more powerful. The so-called

'divorce', in 1981, between the government and the central bank implied that the Banca d'Italia was no longer obliged residual government debt. The Bank also dismantled credit controls so as to render more credibility to its anti-inflation policy. The restrictive policy of the Bank helped to bring down inflation but the trade balance deteriorated nevertheless. The Bank pushed the government to adopt a policy of budgetary restraint, but the combination of easy spending and the high debt serving had a depressive effect on domestic economic activity. As a consequence, the public debt continued soar and the government had to resort to foreign borrowing. In the second half of the 1980s, Italy experienced a significant recovery. The Single European Act, followed by the liberalization of financial capital encouraged a substantial increase of Italian FDI. But the recovery had little effect on the public debt, which continued to soar up to 105 percent of GDP in 1990.

In the early 1990s, accelerating wage costs, loss of competitiveness, led to a new round of speculative attacks on the lira. In the *annus fatalis* of 1992, Italy had to resign from the EMS. At the same time, the Maastricht entry exam for EMU made fiscal restraint a sine qua non if Italy wished to participate in the EMU in 1999. The strong devaluation of 30 percent in 1992 formed the stepping stone of a miraculous recovery and a virtuous succession of policy reforms in the areas of industrial relations, social security and labor market policy and regulation, under the technocratic government of Amato, Ciampi, and Dini. The public deficit came down, debt serving fell, and inflation dropped below 2 percent and interest rates came down. In conjunction, the succession of policy changes allowed Italy to join the EMU in 1999. Notwithstanding these positive trends, unemployment remained high. Moreover, the policy changes adopted under the pressure of economic internationalization brought no relief whatsoever to the *Mezzogiorno*, as the rift between the North and South deepened in the 1990s.

5.2.2 Industrial relations

In the 1970s the left and the trade union movement were able to push for increased limitations on overtime, a significant improvement of wage indexation, the expansion of social protection and the introduction of disability pensions. Their campaign also led to the abolishment of 'wage cages', which before allowed for differentiation of wages among rich

and underdeveloped geographical areas. Because union membership doubled between 1968 and 1977, the Italian governments in the 1970s, like elsewhere in Europe, sought the support of the trade union in their attempt to manage the recession by persuading the unions to moderate wage claims. This resulted in a neo-corporatist social contract in 1978, which however was not successful in curtailing stagflation. The *scala mobile*, introduced in 1975, fueled an inflationary spiral throughout the second half of the1970s. Moreover, the Italian wage indexation mechanism brought about a considerable reduction of wage differentials, which was partly compensated for by additional wage increases granted to the higher paid, and thus added to the inflationary spiral. In 1983 another social pact over incomes policy and fiscal policy was reached, but again failed – this time because of political opposition. And although the power of the trade unions weakened considerably in the 1980s, this did not provoke a political attack on the Italian trade union movement. Rather, weak governments in the face of industrial decline continued to seek union approval for their policy proposals.

The strengthening of the power of central bank in the Italian political economy changed the nature of the social conflict over inflation, and curbed the power and influence of the trade unions. Under the pressure of EMU, and marked by the political transition from the First to the Second Republic, a more responsive pattern of policy concertation emerged in the first half of the 1990s. Between 1992 and 1993, the resurgence of policy concertation led to a number of agreements, which included, first and foremost, the abolition of the *scala mobile*. Next, a new collective bargaining system was established, based on two levels of negotiations: one at the national (macro-economic) and one at the firm- or territorial (micro-economic) level. Tripartite meetings at the national level allowed for more coordination between incomes and fiscal policy geared towards flexible adjustment to the expected level of inflation. The Ciampi government subsequently lured the social partners into a 'Pact for Work'. While the pact focused first and foremost on the fight against unemployment, it also, and perhaps more conspicuously, aimed at participation in the EMU.

5.2.3 Social-security policy

In the 1960s and 1970s, under the pressure of the left, the Italian welfare state made its big leap forward. From 1968 onwards a number of path-breaking reforms were implemented which have had important consequences for the unfolding sequence of welfare retrenchment in the 1980d and 1990s. 1969 saw the establishment of very generous pension system, which allowed workers to retire after 35 years, regardless of age, with a 70 to 80 percent replacement rate. Full wage continuation for sick workers was guaranteed. Regular short-term earning compensation benefits (the so-called *cassa integrazione*), introduced in 1945 were expanded in the 1970s from the industrial sector to the rest of the economy, with benefits up to 80 percent of last earned wages. Between 1960 and 1980 the total number of disability pensions rose almost five times. The expansion of the Italian welfare state led to the reinforcement of disproportionately catering after labor market insiders, in the areas of old age, invalidity, survivors and short term earning compensations, at the expense of unprotected outsiders like women and youngsters. By the 1980s Italy was on the road of becoming a pension state rather than a modern welfare state, Ferrera and Gualmini argue. Pensions came absorb almost 50 percent of total social expenditure. Throughout the 1960s and 1970s contributions were kept artificially low. As a consequence, public deficits were deployed to finance the further growth of the Italian welfare state.

In the 1980s, proposals were put forward to rationalize the pension system and restore financial balance, by raising the age of retirement and trimming of benefit formulas, but no progress was reached beyond incremental cuts. Contributions were raised and a number of measures were introduced to fight abuse.

The combination of stiff fiscal constraints, pressed by the Maastricht entry exam and the changeover to the Second Republic, opened a policy window for welfare reform. The Amato pension reform included a rise in retirement age for women and men, to be phased in by 2002; a rise of the minimum contribution requirement for old age benefits; the gradual extension of the reference period for pensions, together with new increases in contributions. In 1995 the trade unions agreed with the Dini government in to shift from the old, overly generous 'defined benefit' formula to a new, less generous 'defined contribution' formula, to be phased in gradually by 2008. The government and the social

partners also agreed over the gradual standardization of rules for public and private employees. Finally strict rules on disability benefits and incomes from work, as well as tighter controls on beneficiaries were implemented.

5.2.4 Labor market policy

In the late 1970s some progress was achieved in the development of an active labor market policy in Italy, especially, in the area of youth unemployment, industrial restructuring and vocational training and education. Many of these initiatives, however, failed because implementation problems and because a more generalized preference for the further expansion of the *Cassa Integrazione* to compensate redundant workers. In the 1980s new work and training programs were more of a success, but solidarity contracts and part-time work failed to take root. Again, more path-breaking reforms were only adopted in the first half of the 1990s, including the demonopolization of the public employment service. Placement activities were transferred to the region and private agencies were allowed to set up temporary work agencies. This type of labor market deregulation, it is hoped, will contribute to the diffusion of part-time work in Italy, benefiting the young and women. Territorial pacts and area contracts for underdeveloped areas, which involve not merely social partners but also banks, regional chambers of commerce, are in vogue, following the success of the 'third Italy'. Like in France, the issue of the introduction of the 35-hour workweek is back on the policy agenda, but has yet to receive support from the Italian trade unions and employers' associations.

5.2.5 Record

While the economy improved, the Italian labor market has yet to recover. Between 1995 and 1997, the disparity in GDP growth between the North and the Mezzogiorno's widened. The unemployment rate in 1997 was 12.2 percent nationally; worst affected were women and young people. If we disaggregate the data geographically, the unemployment rate in the center/north was 7.6 percent in 1997. In the Mezzogiorno the

unemployment rate was 22.2 percent, 17.9 percent among men and 31 percent among women. Youth employment: 39 percent for men and 55.5 for women. Those out of work for over a year comprise 73 percent of the unemployed in Mezzogiorno as opposed to 58 percent in the Center/North. The most acute problem in the Italian labor market in the 1990s was the fall of the employment rate from 1992 to 1995 from 55.6 to 51.2 percent, accompanied by a sharp increase in unemployment, which surpassed the level of 12 percent in 1995. In 1995 long term unemployment reached 63.2 percent, the highest level in Europe, reaching a record high of 70 percent in the South. Its too early to say anything sensible about the effectiveness of the recent reforms. Italy has moved from a substantial decrease in income inequality from the early 1970s until the mid-1980s to a modest rise in the recent period. In the 1970s elimination of the 'wage cages' and the institutionalization of the scala mobile achieved a massive reduction of wage differentials. For Italy this can probably be explained with reference to Italian adjustment to the EMU, but it should be mentioned that it probably also reflects a more accurate measurement of incomes at the bottom of the distribution in the 1990s. In Italy the changes in income distribution largely occurred at the extremes and higher-income groups have gained while lower-income groups have fallen behind.

6 Sweden and Denmark

The Scandinavian welfare states are 'tightly coupled' welfare states, although Sweden more so than Denmark. For the Swedish model the intimate ties between Keynesian macro-economic policy, solidaristic wage policy, active industrial policy, elaborate fiscal policy, and active labor market policies, was not the outcome of some kind of grand design. However, in practice it developed as a highly integrated and coherent social and economic policy profile. The core policy goal of the Swedish Rehn-Meidner model was to achieve full employment accompanied with high levels of wage equality. This twin ambition was not that strong strong in Denmark, where the tolerance for unemployment and wage differentials was greater.

In Sweden macroeconomic policy focused on a strict regulation of profit and savings, and a low interest rate policy, coupled with high levels of taxation, geared towards budget surpluses. Denmark was also a high tax country, but budget surpluses were only

realized before the onset of recessions in the 1970s. Profit and savings were never as heavily regulated as in Sweden and interest rates were generally higher to compensate for a chronic current account deficit.

For a very long time, both Sweden and Denmark preside over highly centralized collective bargaining systems, with the Swedish industrial relations system again being more centralized than the Danish one. Swedish peak level bargaining among encompassing organized interests of labor and capital revolved around a high and 'solidaristic' wage policy. Relatively high egalitarian wage guidelines were not only designed to meet the redistributive objectives of LO, they also served an industrial policy target in the guise of a productivity whip encouraging high-skill, high-quality production. High wage settlements allowed competitive firms, sectors and regions to expand, and forced inefficient companies to restructure or go out of business. By so doing, Swedish wage policy promoted the continuous modernization of Swedish industry, which was also financially undergirded by long-term patient capital through state-financed loans. In the interplay between peak level bargaining and active labor market policies, wage increases without inflationary pressure complemented macroeconomic regulation of savings and investments. Successful labor market policies and training programs for redundant workers facilitated job growth in the dynamic sectors of the economy and curtailed wage pressure.

Denmark lacked the Swedish labor market priorities and was also less effective in controlling wage pressure, because the greater degree decentralization in the Danish system of collective bargaining. All in all the Danish product and labor market were always less regulated or more liberal than the Swedish. Also industrial policy had a low profile in Denmark until the 1980s. (Benner and Vad 1998; Pontusson, 1997; Iversen, 1998, Elvander, 1988, Goetschy, 1994).

The Nordic welfare states execute universalist and highly redistributive systems with generous, tax funded, social benefits. The heavy tax-burden corresponds to the large public sector and a high degree of income equality. The institutionalized commitment to full employment for both men and women explains the large size of a service intensive public sector, which expanded rapidly since the mid-1960s in both Denmark and Sweden. The service-intensive welfare state is an important employer for women

working in child care, education, and health care. The Nordic welfare states cater after extremely high employment rates of just under 80 percent for both men and women

6.1 Sweden

The Swedish experience of the 1990s is exemplary of the difficulties of reforming a welfare state that was highly coordinated in a particularly successful manner in the 1970s and early 1980s, when confronted with the first waves of economic internationalization. Sweden pursued an effective response of fiscal stimulation after 1974. The basic choice for a soft currency policy to the fall in aggregate demand, resulting from second oil shock, helped to restore the competitiveness of the Swedish economy after 1981, while maintaining high levels of employment. When organized wage restraint, needed to support an accommodating monetary policy, broke down in the mid-1980s, Swedish policy makers were unable to contain inflation. Rising interest rates, low profitability, domestic overheating, and the inflationary spiral, finally, caused the breakdown of celebrated Swedish model. After capital controls were lifted in 1985-86 and the Krona was pegged to the D-mark in the early 1990s, a radical surge in unemployment could no longer be avoided. The Scandinavian recession was exacerbated by the high interest rates policy of the Bundesbank in the wake of German unification. This limited the scope for the further expansion of the public sector, the adjustment of the exchange rate, and other measures to boost demand and employment.

6.1.1 Macro-economic policy

In response to the first oil-price shock, the Swedish response centered on fiscal stimulation to boost demand and maintain full employment. The expansive macro-economic policy package included large state subsidies to ailing industries and extensive labor market training programs. In addition, the fall in employment in the exposed sector was compensated for by a swift expansion of the public sector. In the second half of the 1970s, the Swedish economy suffered from a growing budget deficit and a rise in the current account deficit, which contributed to the rise in interest rates. Swedish monetary policy makers were quick to devalue the krona in 1976 and 1977 so as to restore

competitiveness.

During the 1980s monetary policy really took the place of fiscal policy as the primary tool of adjustment. Against the background the international environment of high real interest rates, the Palme-government opted for a large 'surprise' devaluation of 16 percent, after 10 percent devaluation in the previous year, in the face of the second oil-price shock. The devaluation was highly successful in helping to restore high levels of growth and full employment. However, the long-term success of an accommodating monetary policy is critically dependent on organized wage restraint by the social partners. In order to avoid inflationary effects, many indexation clauses were abolished in 1981 and 1982. In the second half of the 1980s, mounting inflation led to a speculative housing boom, stimulated by untimely financial deregulation. Confronted with an overheated economy, in 1989, Sweden was faced with the choice between cooling down the economy in an attempt to regain control over inflation or to restore competitiveness by another round of devaluation. In the context of the swift liberalization of international and domestic capital markets, the Swedish government applied the breaks and embraced a hard currency policy. In 1991, the krona was pegged to the ECU, and the government firmly committed itself to a fixed exchange-rate policy. This response constituted a major shift in Swedish macro-economic policy priorities, whereby full employment was traded in for price stability as a primary target. But the timing was bad. The shift to a hard currency policy together with restrictive fiscal policy, in the midst of a severe international recession, caused a dramatic fall in domestic demand in the early 1990s. This, in turn, contributed to a steep increase in unemployment together with a further rise in the budget deficits. Unable to defend the Swedish krona, the government was forced to let the currency float in 1992. As the crisis deepened, between 1991 and 1993, GDP dropped by 5 percent and the rate of unemployment increased from 1.6 percent in 1990 to 8.2 percent in 1993. In 1993 the central bank gained full independence from the government; its credible commitment to price stability has brought down inflation, but unemployment remained high.

6.1.2 Industrial Policy

In the 1970s, Swedish policy makers successfully expanded industrial policy. The Swedes makers came under pressure in the 1980s to move away from a strictly regulated to a deregulated market economy. It was argued that strict regulation of credits negatively affected profits and investment, in comparison to international competitors. The business community successfully pushed for the deregulation of the credit market and reduced tax rates on corporate income. Most capital controls were lifted during the 1980s, like in most other OECD countries. The deregulation of credit market was poorly timed, Huber and Stephens argue, as prevailing generous tax deductions for consumer interest payments fueled an unprecedented credit boom (Huber and Stephens, 1998). One of the unintended consequences of financial deregulation was the expansion of the 'grey' financial market and substantial liquidity increases of the largest companies. In conjunction, the inflationary cycle, resultant from recurrent devaluations, and the prevalence of highly attractive deductions on for instance housing loans, contributed to the overheating of the domestic economy.

6.1.3 Wage policy and industrial relations

In the original Rehn-Meidner Swedish model the core policy linkage is the one between macro-economic policy and the centralized system of collective bargaining. Fiscal stimulation and the accommodating exchange- rate policy that the Swedes pursued in the 1970s and 1980s facilitated the return to full employment strategy, but in the long run, fiscal stimulation and recurrent devaluations clearly depend on across-the-board wage restraint. After the wage explosion of 1974-76, Swedish centralized wage bargaining, accompanied by a series of income policy measures, was able to revive a strategy of wage moderation and wage compression. Likewise, the devaluation-led recovery strategy after the 1982 elections was based on an advanced agreement between the social democrats and LO not to demand compensation for increases in the costs of living, resulting from higher prices. After 1982 it became increasingly difficult for LO to accept wage restraint at a level necessary to maintain competitiveness and employment. The radicalization of the trade union, already in the 1970s, had increased inter-union rivalry between white-collar and public-sector unions, on the one hand, challenging the privileged

position of the exposed sector unions within LO. In addition, growing strain between the LO and SAF, undermined the institutional capacities of the social partners to curtail inflation through organized wage restraint. In particular, the solidaristic part of the central wage bargains contributed to a wage drift, which undermined the moderating effect of central bargaining. The failure to control inflation, in the face of slow growth and the deterioration of competitiveness, in turn, provoked repeated exchange rate adjustments. The centralized bargaining system finally broke down, first, in 1983, when employers in the metal industry were able to conclude a separate agreement with its workers. This bargain set the example for the proliferation of sectoral bargaining in the 1980s and 1990s. In the long run, the breakdown of centralized bargaining placed the Swedish model under considerable pressure to change monetary policy into a non-accommodating regime.

The experience of an overheated economy in the late 1980s shows what happens when accommodating macro-economic policies are no longer supported by central wage-coordination. In the absence of central control, under the condition of a tight labor market, it proved impossible to prevent unions in the booming sheltered sectors from exploiting their bargaining power. Tight labor markets encouraged employers to offer high wages. As a consequence, wage increases accelerated, property prices soared, and inflation spiraled, resulting in a dramatic drop in Swedish competitiveness. Although this condition of predicament could have been an argument for renewed centralization, Swedish employers were opposed to any type of revitalization of central wage coordination. They recognized that with suspension of capital controls, while the krona remained vulnerable to international currency speculation, an accommodating monetary policy option was effectively ruled out. In short, it was impossible to deal with the problem of high wage and price inflation without abandoning the Swedish objective of full employment. Wage moderation in the 1990s therefore should be understood as the result of the rapid increase in unemployment in both the exposed and the sheltered sector. In 1995, as the Swedish economy recovered, the Swedish industrial relations system was again marked by major conflicts over wages and working conditions. The Carlson government has tried to re-establish a form of policy concertation between the government and the unions and the employers, however, to no avail. Even threats to intervene in the bargaining process

with a mandated incomes policy, have not lured the social partners to re-explore the benefits of policy coordination. In order to forestall any possible return of centralized wage coordination, the central employers' confederation, SAF, effectively dismantled its negotiating organization in 1992. For them only decentralized bargaining has a future.

6.1.4 Social security policy

The Swedish social security system was relatively unaffected by the crises of the 1970s and early 1980s, as the Swedish model was able to maintain full employment at very high levels. The oil-crises served the Swedish welfare state rather well as it resulted in a massive expansion of labor intensive 'women friendly' social services in child care, elderly care, education etc. The crisis of the early 1990s however shattered the foundation of Swedish social policy. Rather than contributing immediately to a restructuring of the system of social security and financing, the Swedish strategy aimed at controlling and reducing social expenditure through several crisis packages. In line with the response of the continental welfare state in the 1980s and 1970s, Sweden introduced and expanded early retirement schemes to encourage exit from the labor market in the early 1990s, which led to a substantial drop in employment. In the depth of recession of 1991/93 reforms were adopted, which included a reduction in replacement rates, the introduction of waiting days, reduction of pension, changes in eligibility criteria, and increases in the efficiency of welfare programs. There are plans to introduce a new pension system on the basis of defined contribution and not defined benefit, a system that will be funded by equal contributions of employers and workers from the payroll. In social service delivery there is a trend toward allowing competition, the introduction of market delivery models, privatization of welfare services, and transferring administrative responsibilities from the states to counties and municipalities. A voucher system is introduced in education, private providers in day care are allowed to expand, and patients are free to choose their own doctors (Huber and Stephens, 1998). Health insurance contributions were raised, family support reduced, and expenditures on pensions and labor market programs cut. Replacement rates were reduced from 90 percent in the 1980s to 80 percent by the Bildt government (1991-94) and, subsequently to 75 percent by the Persson government in

1995. However, already in 1997 they were again increased to 80 percent. At the same time changes in the tax base brought about an increase in rents and led to a drastic reduction in construction. As a result, social housing has been reversed from a costly program to become a source of revenue.

6.1.5 Tax Policy

The Swedish tax system, based on the three principles of stimulating corporate profit reinvestment, increasing the redistributive effects of personal taxation and the financing of social policy through general taxation, was also unaffected by the crises of the 1970s. The government did reduce income taxation in 1974 in an attempt to lower the pressure on wage increases. But as these reductions were financed out of increases in payroll taxes, the costs of production increased and exacerbated inflationary pressures. The 'tax reform of the century', adopted in 1990, established a dual income tax system. Corporate, capital and personal income taxes were separated and taxed with similar low nominal rates. The progressivity in the Swedish tax system was reduced as marginal rates were lowered in the middle and higher income brackets. Together with the shift towards a fixed exchange rate between the Swedish krona and the D-mark, the purpose of the 1990 tax reform, which also curtailed tax-deductions, was to bolster Swedish exports while controlling for the inflationary effects of the speculative boom. Because of bad timing, the tax reform package served to intensify the Swedish crisis. The 1990 tax reform cooled down the economy at a time when it was already moving into recession as mentioned above.

6.1.6 Labor-market policy

Throughout the period under study, Swedish labor market measures continued to focus on vocational training, public job creation, active counseling, and subsidizing labor mobility. To be sure, together, Swedish macro-economic policy, industrial relations and labor market policies were for most of the 1970s and 1980s fairly effective in creating jobs and the right incentives for industrial restructuring. This is no longer the case for the 1990s. As macro-economic policy and wage policy turned less effective, this had serious implications for the once famous active labor policy (which?) that was part and parcel of the Swedish model. Over the past decade organizational changes have been introduced

and administrative responsibilities have been transferred to the municipalities. Still, the level of spending on active labor market policy in Sweden was left unaffected, and, as a consequence, is still at a much higher level than in the majority of the countries in our study. Welfare cuts in the 1990s were accompanied by increased spending on active labor market policy. This seems to suggest the reinforcement of a policy priority of 'activation', which puts more emphasis on incentives. Recent studies indicate that some of these measures have been counterproductive, but that at least counseling and intensified placement activities continue to contribute to employment opportunities. In Sweden, active labor-market policy, albeit in a lean fashion, is there to stay.

After the 1990s recession it has been generally accepted that there is no longer any scope for the expansion of the public sector. In 1994, reductions in payroll taxes are offered to firms to strengthen the incentives for private sector job growth.

6.1.7 Record

For many years Sweden was looked upon by many as the ideal welfare state based on the apparently perfect compromise between international competitiveness, full employment and high levels of social security and equality. In the 1990s, this image had subsided. Within the course of just a few years, Sweden experienced steep falls in employment across sectors. Economic growth was and still is sluggish. Public revenue declined rapidly and Sweden built up a large budget deficit. Accordingly, the Swedes now score well below the OECD average with respect to GDP per capita while inequality is rising significantly. Sweden has moved from modestly decreasing inequality to a significant rise, reflecting especially the massive shedding of labor following the traumatic crisis in the early 1990s. The largest losses in income shares occurred around the median for the three middle-income quintiles from the mid-1980s onwards.

6.2 Denmark (INCOMPLETE)

The Danish sequence of policy adjustment is quite similar, but not identical, to the Dutch experience. It can be described in terms of six policy shifts implicating just as many policy areas. Already in the wake of the first oil-price shock unemployment rose in Denmark to a

level of 10 percent in the early 1980s. In the late 1970s, it became apparent that the problems confronting the Danish economy revolved around two - interconnected - weaknesses. There were: 1) small, fragmented, and not very competitive industrial sector, which led imports to exceed exports and contributed to a chronic current account deficit; and 2) the large, growing and increasingly expensive public sector, which was to blame for a constant rise in the tax burden, which in turn undermined the competitiveness of Danish industry. In 1979 Danish policy makers decided to shift to a hard currency policy by pegging the Krone to the D-mark. This was a precondition for the subsequent adoption for fiscal restraint and wage moderation, both planned in the late 1970s, but firmly established in the early 1980s and beyond. Concurrently, the Danes developed an ambitious industrial policy, for which there was really no tradition in Denmark. Wage moderation really became effective in the second half of the 1980s at a time when also the industrial policy program seemed to contribute to export growth. Subsequently, the policies offiscal restraint, wage moderation, and industrial policy were complemented with important tax and pension reforms, which served to stabilizing the economy at a competitive pace. Finally in the 1990s, against faced with two-digit levels of unemployment, Denmark adopted a whole range of active labor- market policies, in the context of a well-timed, short-term, expansionary fiscal policy, which contributed to higher investments and an increase in the demand for labor, when the Danish economy picked up in the mid-1990s and unemployment fell to about 7.5 percent in 1997/98. (**points which should be mentioned**: stop-and-go policy in the 1970s -> rising current account and public deficits, increasing unemployment -> deep crisis in the early 1980s -> tight fiscal policy and wage moderation from 1982 onwards -> economic recovery between 1982 and 1986, which reduced the public deficit and increased employment, but aggravated the current account problem and contributed to a overheated economy -> potato-diet in 1987 -> low economic growth in the late 1980s and early 1990s, but a return to wage moderation and a strong improvement of the current account balance paved the way for a favorable economic development in the 1990s)

6.2.1 Macro-economic policy

Denmark joined the Snake when it was formed in 1973, and it subsequently became a member of the EMS in 1979. (<- does not belong to the Danish story). Thus while the Danish real effective exchange rate appreciated by 18 percent in the first three years of their membership in the Snake, Sweden achieved significant improvement in competitiveness by way of strategic devaluations. In 1979, Denmark finally decided to devalue the Krona, but the devaluation was too small to have strong positive effect on private domestic demand and competitiveness. Moreover, it should be emphasized, that within the EMS devaluations had to be negotiated with the other members of EMS, and these allowed only for small devaluation that was not enough to accommodate nominal wage increases. As Danish inflation was above German levels, to make things worse, Danish interest rates were higher. The (too) small devaluation seemed to contribute to the fear of investors and Denmark had to operate with very high interest rates - almost 12 percentage points over Germany's - to attract the necessary investments to keep the economy rolling. Unemployment rose dramatically from about 2 percent in 1972 to over 9 percent in 1981.

Inflation, stimulated by the devaluation, soared and private and public demand for foreign products continued to increase despite rising deficits and a growing debt burden. At that point interest rates were so high that housing construction had come almost to a complete halt, and the public debt was rising exponentially. At the turn of the decade, Danish policy makers had learned the lesson that devaluations were not a viable answer to the Danish crisis in the long run. Rather, it was now understood that the weaknesses of the Danish economy could only be resolved by protracted wage moderation together with improvements in the quality of Danish products in export markets. The precondition for a comprehensive industrial policy strategy and long-term wage restraint was that inflation had to come under control. In order to alleviate inflationary pressure, Danish policy makers opted for a hard currency policy. In 1982, the Krone was then officially pegged to the ECU and the D-mark, which reflects a fundamental reorientation of economic policies. Next to the new low-inflation policy, credibility was achieved by liberalizing capital markets, eliminating budget deficits, and suspending all cost-of-living indexation and through increases in taxation. Restrictive macro-economy policies were to be bolstered by wage

moderation, productivity increases, and process and product innovation.

The pegging of the Krone to the D-mark did not immediately resolve the Danish predicament, as the current account position worsened after 1983, which forced the central bank to increase interest rates which again undermined Danish competitiveness. The government intervened with a crisis package, which significantly cooled down the economy after 1987 onwards. Only in 1993, a new government, led by social democrats, was able to deploy a well-timed expansionary policy, financed by a new (temporarily under-financed) tax reform to get out Denmark out of a seven- year period of low growth and high unemployment.

6.2.2 Tax policy

While Danish macroeconomic policies failed to alleviate the impending unemployment crisis in the 1970s and early 1980s, the public deficit increased substantially. There were no attempts to balance the budget before 1987 (???, between 1982 and 1986 a deficit of 9.1% was turned into a surplus of 3.4%), when Danish tax system went in for a major overhaul, which introduced a dual tax system. The rates on most sources were lowered. The base was at same time being broadened in order to reduce the vulnerability of the Danish tax system to tax competition. At the same time it has increased savings incentives for the benefit of a more stable growth pattern. One of the interesting lessons of the reforms is probably that for a tax system to be effective it does not have to be simple but rather differentiated, distinguishing between more or less mobile actors and assets within each base.

6.2.3 Industrial Policy

In the wake of the first oil crisis, Danish policy makers discovered the inherent weakness in the small and fragmented industrial basis. After the second oil crisis an ambitious industrial policy program, to improve the conditions of Danish industries in world markets was implemented in the 1980s. This concerted industrial strategy is really one of the few in our study that was in fact fairly effective in its combination of large-scale subsidization and credits with technical and commercial guidance for innovation and exports. Moreover,

industrial policy helped to sustain the level of employment in the exposed sector for much of the 1980s. In the 1990s, the emphasis of Danish industrial policy again changed in orientation. Today, the service sector is rightly considered the main engine of growth and employment in the Danish economy.

6.2.4 Wage Policy and Industrial Relations

In the 1970s wages continued to grow at a higher pace than the rise in consumer prices and also compared with many other countries in our sample. In 1982 the new Conservative government, decided to abolish all wage indexation clauses, when it officially pegged the krone to the D-mark, namely in 1982. However, this did not bring about wage moderation in the decentralized system of Danish industrial relations. Despite a partial return to centralized bargaining in 1983 and 1985, wage increases remained high until the mid-1980s. In 1987, the government responded to the pressure building up against the Danish Krone, as a result of rising current account deficit. It introduced a wage freeze and a reduction in tax deductions on interest payments to cool down the economy. The social partners signed the '1987-declaration of intent' with an eye keeping wage increases below the level of Denmark's main trading partners. Under this condition of predicament the social partners turned to a form macro-economically responsive, coordinated sectoral bargaining, which enabled them to produce wage restraint under the shadow of the European Monetary System. For the 1990s, the Danish case, like the Dutch, shows that non-accommodating in a sector-based bargaining system is compatible with wage restraint and good economic performance. In recent years coordination between the social partners and the government has led to an agreed to 'norm of wage bargaining' with a strong orientation, like in the Netherlands, towards the further enhancement of labor force participation.

6.2.5 Social Security Policy

The 1970s were marked by a continuing expansion in social policy programs. The Danish response to the rise in unemployment reveal both characteristically Nordic and Continental features. Like in Sweden, the Danes expanded the public socials service

sector., In a typical continental fashion, they reduced labor supply with the help of an early retirement policy, introduced in the late 1970s. In the 1980s, the Danish government made a number of attempts to reduce spending. Huber and Stephen highlight a variety of measures: increases in the selectivity of benefits, introduction of income testing, temporary de-indexation, changes in eligibility criteria, and the introduction of waiting days. Many of the cuts were directed at unemployment insurance to result in a drop of the effective replacement rate from 72 percent in 1979 to 58 percent in 1987. All in all, low paid workers have compensated for many of the cuts. The most import changes came with the large expansions in public and private labor market pensions, which followed the tax reform of 1987. With respect to reduction of labor supply, Denmark also expanded early retirement programs, but also substantial improvement in paid leave in various forms. In the 1990s, however, the social policies have been tied closely to the more active labor market policies and part of the goal to increase labor-supply. By lowering the tax rate for low-wage earners the government hopes to reduce work disincentives for this group. A new 'active work' line revolves around subsidies for industries employing new entrants, improved vocational training and education, further tightening of eligibility criteria, ceilings on wages for public employment programs and the responsibility for employers for the first two days of unemployment compensation. Meanwhile, citizenship pensions have been subject to income testing (Huber and Stephens, 1998).

In 1993, a reform of the system for financing unemployment benefits was introduced. Before, workers paid for about 33 percent of the costs of unemployment insurance, with the rest being financed out of general taxation. In order to reduce the costs of the state a 'labor market premium' was introduced. For workers this meant that a 5 percent share of their gross income (increased to 8 percent) was earmarked to contribute to the unemployment insurance funds. The central aim of the reforms was to maximize the chances of the unemployed for finding a job. The period of financial support available through unemployment insurance was limited from nine to seven years (in 1996, to five years), while youngsters under the age 18 can no longer claim these benefits. Failing to accept a reasonable job offer can result in one week's loss of benefits, which if repeated may result in the expulsion from the unemployment insurance scheme.

6.2.6 Labor- market Policy

Danish labor-market policy has always been far more passive than the Swedish. Apparently, the tolerance for high levels of unemployment has been rather high. Only in the 1990s, we observe a U-turn in Danish labor market policy priorities. It is generally being realized that the labor force and employment has to increase, not decrease, to finance the fast rise of non-working or inactive people, especially elderly. Finally, 1993 is the time when the Social Democrats return to power and they are eager to make a difference after more than a decade in opposition. The active labor market policy was implemented from 1994 onwards and it has been successful in reducing especially long-term and youth unemployment.

In recent years there has been considerable decentralization from the level of the central government to provincial and local authorities, especially with respect to the execution and implementation employment policy. This has enabled improvement in the quality and flexibility of employment services, job centers, educational institutions, benefit administration, employers and the trade unions. Many activation schemes are now available, ranging from subsidies for the unemployment to set up their own firms, job experience rights in the public and private sector, paid by employment subsidies, job

Rotation schemes in both the private and public sector, special work experience programs for the low skilled, and subsidies for educational purposes for a period up to two years. After three months of unemployment the claimant is offered an interview and 'back to work' strategy suited to his or her qualifications and work experience.

The so-called 'withdrawal schemes' which allow workers to take a sabbatical or period of extended leave have been greatly expanded. The core idea behind these schemes is that new vacancies for the unemployed will become available, albeit on a short-term basis. However, by (re) introducing the unemployed to the world of work the intention is that they will gain valuable work experience, skills and contacts, thereby enhancing their chances of finding regular employment in the future. Other possibilities for leave include extended parental leave and educational leave.

6.2.7 Record (incomplete)

The 1990s have been a rather pleasant decade for Denmark. The situation in the 1990s is namely that growth rates have been rather high relative to the OECD-18 average. More so, employment is increasing again and unemployment has come down to a level of only 5-6 percent with no clear negative effect on inflation levels. At the same time it is noteworthy that the public budget and current account have displayed a continuing surplus until recently and levels of social protection and equality continue to be high. The relative wages of public sector workers have been declining, and a series of budgetary and administrative reforms have been undertaken with the aim to control public expenditures. Public employment reached a maximum in the early to mid1980s. The number of people in employment as a percentage of the working population has dropped from its peak 76 percent in 1986 to about 70 percent in 1994 in the case of Denmark. Income inequality has risen over the past decade. The changes in income distribution largely occurred at the extremes but in contrast to the other countries with changes at the extreme it is lower-income groups that have gained and the higher-income groups that have fallen on the distribution in Denmark. Wage dispersion for Danish manual workers diminished by about 54 percent between 1963 and 1977, while in the same period from 1970 to 1982 the decline for salaried private employees in Denmark was 26 percent.
In Sweden, wage dispersion in the LO-SAF area decreased by about 54 percent between 1970 and 1980, Nordic welfare state have had the most compressed wage structures in the OECD. In the Nordic welfare state, employment in private services has been stagnant or declining throughout 1970-92 period, whereas public sector employment rose rapidly during the 1970s and early 1980s. The result is that the number of people in employment as a percentage of the working age population has dropped from its peak of over 82 percent in 1989 to about less than 72 percent in 1994, still much higher than in the continental welfare states, but nevertheless a clear departure from the past.

7 Britain and the Antipodes

The Liberal/Anglo-Saxon welfare states in our sample can be considered as relatively loosely coupled policy areas. In terms of macro-economic policy, the United Kingdom, New Zealand, and Australia conform to flexible ('stop-go') macro-economic policy with a politically dependent central bank and a small public sector. With respect to industrial policy, the differences are greater. The UK adheres to a 'laissez faire' tradition of autonomous firms, although in the postwar period the UK presided over large nationalized industries in coal mining and public utilities, with suffered from low levels of productivity because of a skill-deficit. The Antipodes, New Zealand more than Australia pursued in the 1950s and 1960s a policy strategy of 'import substitution'. The Anglo-Saxon systems of industrial relations are characterized by a tradition of voluntarism, a high degree of decentralization, closed shops, and a lack of institutions social partnership. This is perhaps more true of the UK, than of Australia and New Zealand, which both allow for some state intervention in industrial relations through the courts system. British trade unions, even under the umbrella of the TUC, have remained fragmented, like their employer counterparts. In all three countries, social security is based on the Beveridge model of a modest means tested individualized system of social assistance on the basis of proven need. Beyond these minimum standard there is substantial scope for private arrangements, for instance in pensions. A low tax burden corresponds to a limited degree of redistribution.

Labor market policies are weakly developed in the Anglo-Saxon countries. The labor markets in the Anglo-Saxon are highly deregulated with liberal hiring and firing legislation. There was no minimum wage legislation in the UK until 1999. By contrast, in Australia and in New Zealand the minimum wage has been set at a relatively high level. Employment levels are relatively high at around 70 percent in the early 1970s. Finally, the market-conforming Anglo-Saxon political economies neither pro-actively encourages women to enter the workforce, nor do they discourage female employment. Female employment is relatively high due because of the low level of social protection and flexible labor markets.

7.1 The United Kingdom

Apart from New Zealand, the United Kingdom experienced the most pronounced U-turn in policy adjustment in our country sample. This has to do with, on the one hand, an outright

policy failure on the part of the Labour government in the 1970s to construct a negotiated incomes policy in the face of the most severe crisis of stagflation in the advanced capitalist world. The mismanagement of the crisis in the so-callled Winter of Discontent, discredited for a long time the Labour Party, and the trade union movement probably even more so. On the other, the Westminster model of democracy, gave the incoming Consvervative government substantial leeway for a radical policy change. The Thatcher experiment comprised of a comprehensive package of monetarist macroeconomic policy, deunionization, deregulation of labor and product market, and a substantial shift from direct to indirect taxation. With respect to social policy, Thatcher unleashed a moral crusade against the welfare and, more generally, state intervention in the economy. It is interesting to observe that Blair, elected in 1997, has so far not reversed the Conservative reform. To be sure, it is difficult to renege a policy tradition of twenty years, under the banner of the 'Third Way'.

The British welfare state, even before the Thatcher revolution, never was a truly 'tightly coupled' welfare state in terms of the interdependencies between policy areas and the degree to which these interdependencies were politically coordinated. Throughout the Conservative era, we observe a further decoupling of social and economic policy and a refusal of any kind of cross-sectoral policy coordination, especially with non-state actors, in favor of radical market solutions. The Winter of Discontent formed the watershed in the British adjustment process, and it remains a sticking point even for the Blair government today, which explains its tenuous relationship with the trade union.

7.1.1 Macro-economic policy

British macro-economic in the 1970s is best described as a range of failed attempts to break with the traditional stop-and-go pattern and to increase competitiveness of British industry in order to come to grips the chronic current account deficit. The decision to allow the pound to float in 197? was followed by a substantial depreciation of the currency, which against the background of the world-wide commodity price boom, worsened the problem of imported inflation. In connection with the inability to deliver wage restraint, a wage-price spiral was set in motion, ending up in a serious stagflation problem in the late

1970s with both unemployment and – to an even higher degree – inflation exceeding the international average. The Thatcher government reversed this development by turning to a strict monetary and fiscal policy aimed to bring down inflation. While inflation could be reduced from about 18% in 1980 to a level below 5% in 1983, unemployment was allowed to rise sharply from 5.6 to 11.2% at the same time and even increased slightly in the years thereafter, which partly offset the consolidation effects of the tightened fiscal policy. In the second half of the 1980s, however, the economic recovery which gained ground from 1983 onwards, not only helped to turn the budget into surplus in 1988, but also manifested itself in shrinking unemployment. Since the economy was in danger of overheating in the late 1980s, monetary and fiscal policy were further tightened, which resulted in a slowdown of economic growth in 1989 and contributed – together with the sharp rise German of interest rates also affecting the United Kingdom as a member of the EMS - to the deep recession in the early 1990s which drove up unemployment again at two-digit levels in 1993. After Britain has left the EMS in 1992, monetary and fiscal policy shifted quickly from a fixed exchange rate to a inflation target and allowed for a budget deficit of almost 8% in 1993 which helped to accelerate the economic recovery and to reduce unemployment substantially since 1994.

7.1.2 Industrial Policy and regulation

Industrial policy became a major area of reform under the Thatcher era as it was part of an encompassing strategy to liberalise product markets. This strategy was pursued both by privatisation and deregulation. With respect to privatisation the sale of public enterprises (and public shares in commercial enterprises, respectively), such as British Telecom in 1984, is worthwhile to mention. Thereby the share of employment in public enterprises in total employment was reduced from 8 to less than 4% until the late 1980s (Klodt 1998). Even more important, a broad set of deregulation measures was enacted aimed to stimulate competition between private and public providers by abolishing public monopolies. Moreover, public subsidies to ailing industries, for instance in the field of coal mining, were heavily reduced.

Industrial policy was also aimed as to attract foreign direct investment, mainly by labour market deregulation, tax incentives and a dismantling of union power.

7.1.3 Wage policy and industrial relations

Massive wage inflation can be regarded as the main cause for the stagflationary development of the British economy in the 1970s. The highly fragmented union structure and the strong commitment of successive labour governments to full employment provided little incentive for British unions to deliver wage restraint. Apart from a short interlude in 1976-77 ("Social contract"), during which some wage moderation could be achieved, any attempts of incomes policy either through statutory pay freezes or joint agreements covering fiscal, monetary and wage policy, did not prevent wage competition. Union's wage claims, partly exceeding the level of 20%, culminated in the "winter of discontent" in 1978/79, when a big strike wave shacked the economy. As a result, trade unions lost heavily in public reputation paving the road for the Thatcherian onslaught on the traditional system of industrial relations and the sustained emasculation of trade unions strike power in the 1980s, mainly executed through a stepwise restriction of their immunity. The Thatcher government dismantled extension procedures and closed shop regulations, repealed the right to strike, lowered collective bargaining coverage, and saw to the further decentralization of bargaining to the firm level, etc. Partly as a consequence of this union bashing strategy, wage increases could be brought down to more moderate levels since. The strategy of deunionization led to an enormous increase in wage differentiation. By and large the Blair government, coming to power in 1997, has so far not rehabilitated the trade union movement as a key actor in social and economic policy.

7.1.4 Social security policy

The welfare state which, by and large, remained in tact for most of the 1970s (?), came under massive ideological pressure under the Thatcher administration, which is not reflected in the development of aggregate spending figures, however. While the expenditure-heavy benefits for the middle classes withered the storm of retrenchment comparatively well, programmes targeted at the lower end of society, such as social assistance and housing benefits, were cut back most clearly. The conservative governments also pursued a strategy of systemic retrenchment, aimed to undermine

popular support for the welfare state in the long-run. For instance, private provision was promoted by introducing contracting-out clauses in the States Earnings Related Pension Scheme. Also, long-term effects of changes in the indexation of social benefits (make wages rising faster than benefits) are likely to have reduced the attractiveness of social security schemes especially for middle and higher income strata. The structure of the social security system has also been changed towards a strengthening of work incentives, not only through a reduction in unemployment and social assistance benefits, but also through a lowering of high effective marginal taxes at the lower end of the income scale due to higher taxes and loss of transfer payments as a result of higher working income. The introduction of the "Family credit" in 1988 (a degressive allowance topping up net income) was explicitly designed to tackle this problem of poverty trap. While the Blair government did – by and large - not reverse the cuts in social security executed by the conservative governments, its main focus is a shift from consumptive to more investive expenditures such as research and development, education and active labour market policy.

7.1.5 Labour market policy

While employment protection was extended in the 1970s, the conservative governments switched to a policy of heavy labour market deregulation and flexibilisation, such as a relaxation of dismissal and working environment rules and the abolition of statutory minimum wages in 1993. By and large, the Blair government did not reverse these liberalisation reforms. One exception is the reintroduction of the statutory minimum wage in 1999. A major policy change revolves around the expansion of active labour market policy, education and child care facilities, mainly aimed to combat youth and long-term unemployment.

7.1.6 Tax policy

Major adjustments have taken place in the tax system during the 1980s. The main tax rate was lowered from 52 to 35% until 1987. Income tax rates were drastically reduced in the 1980s and 1990s, most notably the marginal top rate, which fall from 83% in 1979 to 40% in 1992. These reductions were mainly compensated by an increase of indirect taxes.

Thus, the conservative tax reforms, display strong regressive elements of redistribution clearly favouring the middle and higher income brackets. This added to the increased wage dispersion that followed the policy of deunionization and deregulation.

7.2 New Zealand

The New Zealand responses to the pressures of economic internationalization have been radical but not especially effective in creating jobs and maintaining decent levels of social protection. But the question is whether the New Zealand reform process, which led to serious inequalities after mid-1980s, could have followed a different route, given what Schwartz and Rhodes identify as New Zealand's main policy mistakes: a last disastrous round of import substitution in the late 1970s and the inability to develop a responsive incomes policy. In any case, it is suggestive that a reform process associated with strong neo-liberal impulses, ranging from deregulation, privatization to welfare retrenchment, has, for the greater part, been implemented by a labor-led government.

The starting point of New Zealand reform process in the first half of the 1970s was a classical loose Keynesian monetary and fiscal policy, which ensured continuing low levels of unemployment until the mid-1980s. This macroeconomic policy combined with trade protection and protected employment compensated for the lack of competitiveness of the New Zealand industry base. According to Schwartz and Rhodes, New Zealand competitiveness was low because of the failure of the weak and fragmented manufacturing and labor bases to institutionalize an effective income policy.

When New Zealand income policy was not able to ensure lower wage inflation and the crisis sharpened in the early 1970s probably as the combined result of the oil price shock and a trade shock following Britain's entry into the EC in 1973, the government turned to large-scale and state-financed (for borrowed money) attempts to create local substitutes for imported goods. However, this New Zealand type of industrial policy was not viable over the long term and the current account and public budget deficit together with hyperinflation and high interest rates threatened to undermine the New Zealand economy. On this basis, the government turned to major currency devaluation in 1984.

The problem with even a large devaluation is, however, that it will only boost competitiveness over the short-term, especially if it continues to be accompanied by

interest rates and inflation rates at very high levels relative to other countries. This was the case in New Zealand, which provoked the government to unleash a fundamental restructuring process from 1985 onwards. The restructuring of the recent New Zealand „model„ started in macroeconomic policy with a shift towards fiscal consolidation and subsequently moved onto labor-market policy and industrial relations where protected employment was replaced by market-conforming wage levels. As the labor market reforms took root, the New Zealand government also began to apply market principles in welfare services, i.e. via user charges, private co-payments, and fees.

7.2.1 Macro-economic Policy

When the New Zealand faced major economic difficulties in the early 1970s the perception was that these could be resolved though currency controls and wage and price freezes, which then were introduced in 1973. However, New Zealand policy makers also opted for a looser monetary and fiscal policy to maintain competitiveness in the exposed sector and high levels of employment overall. In 1975 a series of devaluations, interest rate adjustments and fiscal expansionary measures, including an expansion in public employment were the main new Zealand responses to the first oil crisis.

This line of policy making continued until 1984 when New Zealand policy makers decided to go for a big-bang devaluation of no less than 20 percent in 1984. This was the last devaluation. New Zealand policy makers had already started to realize, with the second oil crisis, that the combination of these traditional macroeconomic measures would not alone be able to bring New Zealand out of its economic difficulties, which, it was argued, were mainly structural. On the basis of this recognition macro-economic policy priorities shift toward a hard currency policy and fiscal consolidation through expenditure cuts and increases in taxes and user charges. This policy shift was accompanied from the mid-1980s onwards by financial liberalization including the abolition of all types of capital flow restrictions and exchange controls. The goal was to attract foreign investments, which it certainly did. Many large New Zealand companies became foreign-owned in the second half of the 1980s. Financial liberalization, like in Sweden, contributed more to a speculation boom than to increases in capital investments.

7.2.2 Tax Policy

In the second half of the 1980s and first half of the 1990s, New Zealand also broadened the tax base and flattened rates. This certainly contributed to increasing inequality. The New Zealand tax changes included the lowering of the top marginal income tax rate from 48 to 33 percent, which was only partly compensated by the introduction of a new goods and service tax on 10 percent increasing quickly to 12,5 percent. Thus, the restructuring of the tax bases contributed to put public finances under pressure, which in turn brought the New Zealand government to conclude that cuts in welfare programs were necessary.

7.2.3 Industrial Policy

The largest shifts in the New Zealand model came in the area of industrial policy where New Zealand moved from protectionism to laissez-faire. The 1970s and to some extent also the 1980s were marked by continued protection and subsidization of ailing industries as well as large scale attempts to create local substitutes for imported goods, which helped sustain near to full employment. The second oil crisis brought attention to the importance of natural resources and in New Zealand there were strong hopes that an export-led recovery on the basis of the utilization of minerals, energy, natural gas, etc., was immanent

Neither the mineral/energy adventure, nor the Think-big program of import substitution were successful or created any positive economic activity worth speaking of. Rather the projects, because they were so costly, contributed to a fast growing foreign debt. On this basis, the government turned to de-subsidization and de- protection on a larger scale in the last half of the 1980s. In the following years, and especially from 1984 to 1987, trade protection for manufacturing and commercial services was significantly removed. The same was true for the subsidies for agriculture and manufacturing. Finally, it was decided in to privatize a majority of the New Zealand state-owned enterprises (SOEs), which took effect in the second half of the decade. However, as the barriers of protection were removed and the SOEs were privatized, unemployment rates could no longer be disguised and the official UE rate rose considerably to more than 7 percent. An

even larger increase was identifiable for youth unemployment in the 1990s. For New Zealand, having tried a range of measures in the area of macroeconomic policy, industrial policy, and wage policy, the logical next step had to be social policy or labor-market policy.

7.2.4 Wage policy and industrial relations

Despite general wage freezes and continuos government interventions in the wage setting of local industries, i.e. in the meatpacking sector, labor market conflicts continued with a clear negative effect on the attempts reduce the levels of wage inflation. In the 1980s, however, union militancy paved the way a new and more radical reforms. The first example was the reform in 1987, which introduced firm level bargaining on a larger scale. It was complemented with the Employment Contract Act in 1999, which ends compulsory union representations in future New Zealand wage setting processes.

7.2.5 Social security policy and labor-market policy

While New Zealand social policy from the mid-1970s to the mid-1980s were marked by continuity or even increases in benefits, the rise in unemployment in the 1980s and 1990s has put intense pressure on public budgets. This unleashed a whole range of ad hoc cuts and curtailments. In the 1990s, nominal benefit rates have been greatly reduced, inflation adjustment was abolished, while the eligibility criteria for several programs were tightened considerably. Concurrently, social policy moved towards a stronger reliance on user-charges, fees, etc. which over time has contributed to a change in income distribution affecting especially low income groups.

In the area of labor market policy New Zealand did very little. High levels of unemployment ate away most the resources for experiment with active measures, including placement and vocational training and education.

7.2.6 Record

The New Zealand responses to economic internationalization have been radical but generally not very effective. Economic performance has been poor. With respect to GDP

per Capita New Zealand represented continuing low growth or even stagnation. The latter was true especially in the last half of the 1980s. New Zealand has performed better with respect to employment. In the 1990s employment is increasing both in the exposed and sheltered sectors and unemployment kept at a low rate. The social cost has been a significantly rise in income inequality since the mid-1980s.

7.3 Australia (still missing)

8 Conclusion: Effective policy responses

8.1 The economics and politics of policy adjustment

Policy adjustment, however much constrained by economic internationalization, is fundamentally a political process. Under conditions of increased economic internationalization we have observed how over the past thirty years changes in the international political economy have come to spill over from policy areas relatively close to the open market to those policy areas that were purposefully designed to protect citizens from the exigencies of market forces, or at least to modify their impact on employment opportunities and income distribution, through political means. We also observe that the more the impact of the ongoing process of economic internationalization reaches into the core policy areas of the welfare state, however, the more likely it is to trigger social conflict, and, as a consequence, the more difficult and the more important the political management of adjustment becomes. Citizens are keen and critical observers, and, as voters, even central actors in the adjustment process. At certain points in time, voters hold governments responsible for the way they manage the economy. The ascendence to power of Thatcher in 1979, Lubbers in 1982, Bildt in 1991, should be seen in this light. By the same token, or even more likely, citizens can vote governments out of office who pursue radical strategies of welfare-retrenchment. This has been the fate of the Juppe government in 1997, and the Lubbers-Kok administration in 1994. Here the economic logic of internationalization meets the more contingent political logic of policy change. When politically guaranteed social rights are at stake, the economic and political logics of

policy adjustment seem to pull in opposite directions, the outcome of which is extremely hard to predict.

We also argue that policy adjustment basically follows a sequential logic, whereby salient policy problems in different policy areas are tackled one at the time. This does not correspond to the policy prescription, often advocated by international organizations like the OECD, that social and economic policy reform should be brought about a part and parcel of a comprehensive reform package, covering various policy areas all at once (OECD, 1994). The argument, from the OECD standpoint, is that a comprehensive reforms strategy is more likely to be effective than incremental adjustment in single policy areas. To be sure, an isolated relaxation of employment protection in face of falling demand for labour, is likely to lead to labour shedding. On the contrary, a combined strategy of relaxing dismissal protection and deregulating product markets could more likely raise the demand for labour. Although the OECD's comprehensive approach may be appropriate from a purely technically economic perspective, it completely lacks an understanding of the political dynamic of policy adjustment. By treating countries as more or less unitary political actors, OECD economists applaud the 'strong political leadership' behind the types of structural reforms that have been adopted in the United Kingdom and New Zealand in the 1980s. We would argue that strong political leadership is not the right specification here. Rather, it is the institutional structures of the political systems of the United Kingdom and New Zealand that permitted the kind of radical solutions sought by Thatcher and Douglas. Because Britain and New Zealand are unitary and majoritarian Westminster models of democracy, this gave the ruling conservative and labour parties in these countries a vast room for political maneuver. However, it needs to be emphasized that these two Anglo-Saxon polities are really the exceptions to the rule. Most of our cases are to a greater or larger degree 'negotiating systems', characterized by coalition governments, different degree of federalism, and active social partnership involvement in the formation and implementation of social and economic policy. Policy reform in such negotiating systems is more likely to be constrained by 'veto power', and as a consequence more likely to follow incremental pattern of policy change.

More important, we argue that policy adjustment is fundamentally a dynamic process. In a world of increased international openness, intensifying competition, rapid technological

and organizational change, the shift to services, demographic ageing and changing family relations, a one size-fits-all approach is wholly inappropriate, as the policy environment does not stop evolving. Again by studying policy change through a political lense, we have found that by and large policy adjustment follows a logic of failure induced search, whereby salient problems gain political attention at critical moments, provoking policy makers to adopt selective changes within single policy areas. Adopted policy solutions are likely to generate spillover effects in neighbouring policy areas, when new external constraints become manifest, this may subsequently lead to a next cycle of reform in the newly affected policy areas. From a more normative standpoint, we would like to stress that sequential and incremental reforms, as they move at slower pace than radical change, are also less likely to endanger the overall stability of the economic and political system. As 'big bang' reforms could generate massive uncertainty in the period of transition, this could easily undermine economic performance, at least in the short run, reducing the propensity to take economic risks, and may lead to rising social conflict. An erosion of social cohesion, furthermore, is likely to undermine the degree of trust in the economic and political system, which fosters an unstable environment for long-term economic investment, consumer behavior and policy development. The alleged success of the New Zealand model in comparison to the recovery of Australia in the 1980s is a case in point. Throughout the 1980s economic performance in New Zealand has been much poorer, with respect to almost all relevant indicators, not only in comparison to the OECD-average but also interestingly in comparison to Australia, which followed a more incremental pattern of adjustment, based on a social contract between the state, the trade unions and employer organizations (Quiggin, 1998). We observe a similar downturn in the UK, reflected in sharply rising unemployment, after the Conservatives came to power.

8.2 Path dependent but no stereortypical adjustment trajectories

What do the various national adjustment patterns analyzed in this study tell us about the impact of economic internationalization on social and economic policy and the political management of policy adjustment? Does globalization induce a process of convergence, as many observers believe, reducing the diversity of national welfare regimes? Based on the assumption that increasing economic internationalization has also wealth-increasing

effects insofar as it allows a better utilization of comparative cost advantages, we argue, that the three consecutive changes in the international political economy (breakdown of the currency regime of Bretton Woods, sharply rising real interest rates in the wake of the second oil crises and the increased liberalization of capital and product markets since the mid-1980s) are best understood as posing additional constraints for national polities, triggering a variety of policy responses, rather than simply increasing the problem load of the welfare state. These economic constraints, to be sure, interact with endogenous problems of demographic ageing, the shift to services, changes in family structures, etc. It should however be emphasized that *economic* constraints in the face of a dramatic policy failure can act as a window of opportunity in *political* terms to pursue pathbreaking reform. In this sense the title 'rescue from without' aptly captures the character of the Italian *Risanamento* in the 1990s.

While the intensity of international constraints has indeed steadily increased over time, we argue that its impact on policy areas close to the market is stronger and more immediate than in the more politically protected sectors. To be sure, macro-economic policy was the first policy area, where the effects of economic internationalization were felt most immediately and where with the passing of time the room for diverse policy strategies has become most severely constrained. In the wake of the first oil price shock, many of the countries in our sample were still able to pursue more or less successful strategies of fiscal expansion. Sweden was able to prolong a Keynesian response by way of a strategic devaluation, supported by organized wage restraint, after the second oil price shock, when many other countries switched to a hard currency policy. However, with the liberalization of domestic capital markets in the context of an overheated econonomy, undermining the continuation of organized wage restraint, in the late 1980s, even the Swedes were forced to abide by a tight monetary policy. Today, moderate rates of inflation and budgetary discipline have become key prerequisites of any successful macro-economic policy. The general shift from full employment policy towards price stability as a primary policy goal induced quite a dramatic convergence in macro-economic policy choices. In the process, macro-economic policy could no longer serve as a buffer, shielding neighboring policy areas from bearing part of the burden of economic adjustment, to the same extent as it still did in the early 1970s. This is not to say, that a

policy of extensive deficit-spending or strategic devaluation is not possible any more as a matter of principle, but it is evident, that international constraints make such a policy by far more costly than in the 1970s. Still, with the switch to more stringent macro-economic policies, part of the adjustment burden spilled over onto other social and economic policy areas.

In the chain of sequential adjustment, industrial policy became a next target of major reform. Increased international competition in product markets and rising budgetary constraints made it more and more costly for governments to preserve high levels of employment in the industrial sector through a heavy reliance on state-owned enterprises, as France and Austria still did in the 1980s. As a consequence, the ability to hoard labor in nationalized industries eroded dramatically. This also holds true for the policy strategies of import substitution industrialization that were prevalent in Australia and New Zealand, and which had to be abandoned in the 1980s. By the same token, in the 1990s, Switzerland faced increased difficulties to deploy its the protected agricultural, retail and construction sector as key shock absorbers.

With the erosion of buffer functions of macro-economic and industrial policy, the burden of adjustment shifted to other policy areas, notably wage policy and the system of industrial relations. With the deliberate move from full employment to price stability as a primary goal of macro-economic policy, in the face of high real interest rates and as a result of increasingly internationalized capital markets, wage restraint became an important requirement for successful adjustment in terms of employment maintenance. The Dutch experience clearly shows how wage moderation resulting in a substantial decline in the wage share helps to boost competitiveness in the exposed sector. In turn, wage moderation helps to slow down or lower the number of people depending on benefits and hence reduce the social wage component. Protracted wage restraint can serve to create more jobs in domestic services that were heretofore priced out of the regular labour market. Finally, wage restraint can allow governments to use improved public finances to lower the tax and contribution wedge at or near the minimum wage and get more low-skilled workers back into jobs (Visser and Hemerijck 1997). However, unlike macro-economic policy and industrial policy, the areas of wage policy and industrial relations fall, albeit to varying degrees, outside the jurisdiction of the national state. Moreover, wage

policy is to a great extent shaped by distributional conflict between the employer organizations and trade unions. The systems of industrial relations, in which these conflicts are fought out, can be located within a wide spectrum of different traditions, ranging from consensual corporatism to decentralized pluralism, and political contestation (Crouch, 1993). In other words, any strategy of wage moderation implicates the institutional capacities of the trade unions and employers' association to deliver restraint. As the burden of adjustment shifts from the area of macro-economic policy to the areas of wage policy and industrial relations, the process of adjustment is likely to become more politicized. Moreover, as wage policy is typically not, albeit for extreme circumstances, under political control, domestic institutional arrangements for collective bargaining and social conflict resolution come to play an preeminent role in the political management of adjustment. It should therefore come as no surprise, that we observe in this area a variable degree of order and social conflict over issues of collective bargaining, together with a greater variety of (effective and ineffective) policy choices. This is especially true with respect to the varying strategies whereby different countries have tried to bring about wage moderation. One possible option for a government is to enter into a package deal with the social partners, rewarding the willingness of unions to pursue wage restraint by delivering various kinds of side payments. The policy strategy of consensual wage moderation was already firmly established and successful in Austria after the first oil shock, when it was part and parcel of a coordinated interplay with an accommodating fiscal policy stance. In the Netherlands in the 1980s organized wage restraint was exchanged for labor time reduction first and tax concessions later. As this consensual strategy failed in Belgium, the government felt obliged to deploy the more blunt tool of legally sanctioned limits on wage increases. In the British case wage moderation was forged by a radical political strategy of deunionization of industrial relations and deregulation of the labor market by Thatcher government. Whereas New Zealand essentially followed the British example, in Australia there was a successful attempt to bring about consensual wage moderation through a social contract. In France wage moderation was to a large degree market driven, insofar as rising unemployment undermined the bargaining power of the trade unions in the private sector. In Germany the shadow of tight monetary policy of an independent central bank helped to dampen the

wage demands of relatively well organized unions in the wake of the second oil crisis.
Although the above countries all pursued a policy strategy of wage restraint under different political conditions and with different institutional capacities, not all countries were equally successful in achieving wage moderation. Italy is a case in point where both a political exchange strategy and a firm monetary policy failed to bring about modest wage increases in the 1980s.

When and where the predicament of adjustment shifted from one policy area to another neighboring areas often took on a specific function in support of the strategic choice made in the policy areas newly exposed to spill-over effects. Since the shift towards fiscal consolidation and a hard currency policy confronted systems of industrial relations with the requirement of wage moderation, the strategy of labor supply reduction through the social security system, came to play an important supportive function for the strategy of wage moderation in the 1980s, as it allowed for a socially acceptable shedding of elderly, expensive, and less productive workers, and the entry of younger, less expensive, and more productive cohorts into the labor market. This is especially true for the continental welfare states. Their heavy reliance on pay-roll financing functions as a productivity whip which force firms to raise productivity levels by way of laying off less productive, mostly elderly workers. Moreover, since continental social insurance systems are to a large extent administered by the social partners there is little organizational resistance against the (mis)use of social insurance schemes as a tool for labour supply reduction.

In the 1990s we observe that wage moderation has become more pronounced, less contested, and more effective, also in Italy, than it once was. However, under the new problem constellation of increased mobility of capital, and for Europe, increased competition in product markets and more important the EMU entrance exam, also up to that point in time relatively unaffected policy areas were obliged to share some of the costs of ongoing adjustment. This was especially true for fiscal and social policy in countries which faced large budget deficits and public debts. Thus we are moving to policy areas in which external pressures are to a greater extent mediated by domestic political factors. By this we mean two things: On the one hand, policy change directly affecting entrenched entitlements will potentially be met with strong political resistance. On the other hand, and partly as a consequence of the above, the institutional architecture of

these policy areas constitutes a greater cross-national variation than in the less politically contested policy areas of macro-economic management. The consequence of this for the dynamic of policy adjustment is that domestic political constraints come to play a preeminent role here. Tax policy is in this sense located at the very interface of the economic logic of increased international competition and the political logic of distributive struggle. As such, we interpret the intense political debate over tax competition going on in many economically advanced welfare states today. Still, the fear of tax competition and social dumping, as Ganghof and Genschel argue, is not reflected in empirical findings. Since the mid-1980s the level of total taxation remained more or less stable in most countries. At best, we observe a lowering of nominal tax rates combined with a broadening of the tax base, together with some simplification of the tax system and stricter enforcement. Still, by and large, tax reform is the politics of the status quo. We argue that relatively stable tax structures in most countries of our sample should be interpreted as a rather fragile tug of war resulting from economic and political forces pulling in opposite directions. With increased economic internationalization the welfare states fiscal sovereignty has become challenged. But governments are tied to prior spending commitments that were introduced in the period of welfare state expansion. These commitments, however, are extremely difficult to renege due to high political costs when countries are confronted with international constraint making a raise in taxation levels more costly than before. Moreover, spending levels are to a large extent, determined by factors largely beyond legislative control such as demographic trends, health status of the population, labour market developments, and growth rates. Together international economic and domestic political constraints, explain why many countries in our sample in the 1980s tackled many of these problems by deficit financing and increased reliance on labour taxes (Genschel, 1999). This interpretation goes against the commonly received argument of Geoff Garrett and others, based on the observation of frozen landscape of taxation, denying any impact of economic internationalization on welfare state development.

Beyond the field of tax policy, the realms of labor market policy and regulation and social security are on the whole, depending on the effectiveness of the more exposed policy areas, less directly and less severely constrained by economic internationalization.

However, it is these areas which in terms of policy design, governance structures, actor constellations, and policy styles are essentially constituted by domestic politics. As a consequence, policy programs tied to these areas display the greatest diversity across countries. Moreover, these policy areas, which form the very heart of the welfare state, are also the ones that are most susceptible to politicization. This is especially true of the programs of social security, constituting a broad range of concentrated income interests and entrenched social entitlements. To be sure, policy change in the sphere of social security should be understood in terms of the political struggle over the distribution of material life chances, rather than a mere technical response to the alleged "requirements" imposed by economic internationalization. Coming from different traditions in policy design and governance structure, we observe only a limited degree of policy convergence in the areas of social security policy and labour marker regulation, despite the many spill-over effects from the more international exposed policy areas. This is not to say that policy adjustment, driven by the forces of globalization, does not affect the core of the welfare state, because it does. But the manner and extent to which these pressures and spillover effects are played out in these politically sensitive policy areas remains highly variegated. What we can detect is a slight convergence or 'hybridization' in the financing structure of the welfare state taking place at the very extremes of array of welfare regimes. In continental systems that have historically been financed almost entirely out of payroll contributions, such as Germany and more so France, there is in very recent years a shift in financing structure towards more general taxation. The reason is twofold. On the one hand, high levels of payroll taxation in the face of increased competition in product markets force firms to relocate production to low-cost countries. More important, a high tax wedge, as a consequence of high payroll taxes, crowds out (low skill) employment at the lower end of the labor market. On the other hand, countries with traditionally very high levels of general taxation, most notably Denmark, are severely constrained to further raise income and indirect taxes for the financing of the welfare state. In the face of domestic tax resistance and tax competition for goods sensitive to cross-border trade, Denmark has recently introduced social contributions as a new and economically and politically less vulnerable measure to fund social policy.

Another strand of convergence, predominantly taking place across some of the continental welfare states, relates to the very recent reversal of labor shedding strategies using early-retirement, prolonged unemployment, sickness, and disability as velvet exit-options. As labor shedding substantially increased the financial burden imposed on the systems of social security, policy actors, most notably in the Netherlands, have come to recognize that a robust welfare state requires a high level of employment rather than a low level of open unemployment. Even in countries where so far we have not been able to establish this trend empirically (for instance in participation rate for elderly workers), we do observe an increased awareness in many of the continental welfare states of that a condition of welfare without work is neither economically sustainable nor politically viable in the long run. This understanding is reflected in the recent pensions reforms in Italy and Germany, where a higher legal retirement age has been agreed upon for the near future. Whether the pathology of welfare without work can be overcome, is critically dependent on positive feedback effects from policy strategies pursued in the more internationally exposed policy areas. What is of special importance here is the degree to which policy interdependencies are the explicit object of institutional coordination. We will address this aspect in more detail in the next section.

The degree of cross-national convergence, directly or indirectly driven by globalization, is area-specific and must be understood against the background of increased international constraints, which over time are played out through spill-over coupled with learning effects across policy areas, curtailing the room of political maneuver and reducing the number of viable policy options in the adjustment process. The remaining corridor of economically viable policy choices, however, widens as we move from the policy areas close to the market to the policy areas that are defined by politically protected industrial and social rights. In these areas there is still considerable room for different national policy strategies, especially in terms of politically feasible cross-sectoral combinations of policy choices. These should not be understood as the inevitable deterministic outcomes of external pressures caused by globalization, but as a result of a more complex interplay between international constraints, domestic institutional structures, endogenous problems, and learning effects on the part of interested policy actors. Still, we would argue, that – given the increasing constraints outlined above and the strategic choices made at earlier stages

in the adjustment process - policy change is likely to proceed *within* well-established patterns of social and economic regulation, which does preclude a country from switching from one regime to another in the adjustment process. This is a path-dependency argument – predicated on earlier policy choices. Differences in public sector employment are a case in point here. Sweden and Denmark, which have been able to radically expand their public sector in the wake of the first oil crisis through a rather successful response of Keynesian reflation, today cannot go back to status quo ex ante of low levels of public employment without facing tremendous economic and political costs. By the same token, other countries in our sample, which in the 1970s would theoretically have had the option to bring public sector employment to the Scandinavian level, are unable to do so under the new problem constellation of globalized markets in the 1990s. Policy responses adopted in the past, their respective successes and failures, shape the room for available policy options in the present. This is not to say that there are homogeneous, regime specific, adjustment patterns. In spite of the forces of path dependence and policy feedback, we do observe that countries belonging to the same family type have pursued markedly different patterns of policy learning, which in some cases have led to quite deviant reforms both with respect to policy content and institutional structure of the welfare regimes, with significant consequences for economic, employment and social performance.

8.3 Measuring performance

The diversity of policy responses is also reflected in their effectiveness. By defining „policy effectiveness“ as the degree to which a welfare state is able to fulfil basic economic and societal objectives, we are able to distinguish four dimensions of welfare state performance: Macro-economic performance (see table a), employment performance (see table b), the level of social protection (see table c) and the distributive outcomes in terms of wage dispersion, income equality and poverty (see table d).

With respect to macro-economic performance we distinguish three different aggregate indicators. The first aggregate indicators is calculated by the following identity (which is basically a variant of the "magic square"[2]):

Macro-economic performance = GDP growth – inflation rate + structural balance of general government + current account balance

Macro-economic performance is a necessary, albeit not sufficient, precondition for employment growth. Empirical evidence suggests that countries displaying a high employment performance also have had favourable growth patterns. Thus, they contradict the popular notion of 'jobless growth'. However, the employment intensity of economic growth, the extent to which economic growth go together with significant increases of employment, is critically dependent on the ability to create demand for labour in the service sector.

The extent to which a national economy is able to combine high levels of economic growth with modest levels of inflation can be regarded as a prerequisite for successful adjustment. Additionally we take into account the structural deficit of general government (thereby excluding the component of public deficit which is caused by economic cycles) and the current account balance as indicators for the long-term sustainability for economic developments. Since a high current account surplus is not necessarily better than a balanced current account (and may be partly result from depressed domestic demand) we use a second aggregate indicator which does not include the current account in the summation (which produces a substantially different ranking of countries in macro-economic performance than the first indicator). Additionally, we provide information on the level of GDP per capita as a measurement for the relative wealth of a country (table a).

For the assessment of a country's employment performance we use the following summation to calculate an aggregate index:

Employment performance = Employment/population ratio – unemployment rate – long-term unemployment rate

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[2] The unemployment ratio does not appear in the equation, however, since it is treated separately as one indicator for a country's employment performance. Instead we choose the structural deficit of general government in 1997 (Maastricht year!) as an additional indicator for macro-economic performance.

While in the process of adjustment political actors seem primarily concerned with open unemployment figures, we argue that levels of employment are a better indicator for labour market performance, as it establishes a relationship between actual gainful employment and the maximum possible work force. Levels of employment are most precisely measured by the employment/population ratio (= total employment/population 15-64 years). Since one may consider open unemployment as a form of social exclusion and thus as a greater "evil" than other forms of non-employment (such as paid leave or early retirement) and, by the same token, long-term unemployment as a greater "evil" than short-term unemployment, we subtract both the total unemployment ratio and the long-term unemployment ratio from the employment/population ratio. To complete the picture we also add empirical information on the level of female employment, on youth unemployment and the so-called benefit dependency ratio. The latter results from the division of the number of persons in the working-age population (15-64 years) relying on income transfer benefits by the number of active persons (that is employed persons without those receiving sickness and maternity pay), expressed in full-time equivalents. This allows to condense the information on the financial burden caused by the inactive segments of the working-age population imposed on the active part (see table b).

Thirdly, the effectiveness of a welfare state has also to be understood in terms of its capability to ensure a high level of social protection (see table c). The generosity of national welfare state arrangements is particularly difficult to measure. As a first proxy we use public (and private mandatory) expenditures used for social purposes as a share of GDP. Since social expenditures are highly influenced by the number of unemployed and elderly persons in society, the social expenditure ratio can only serve as a very rough indicator for the level of social protection. For that reason we take also into account replacement rates of public pensions, unemployment benefits and social assistance. Since this refers only to the transfer side of the welfare state we additionally focus on spending in social services.

A further dimension of welfare state performance is more output oriented and could be labeled as "redistributive performance" (see table d). Here we rely on poverty rates and

Gini-coefficients as the most common indicators for the structure of distributive outcomes. Since these indicators are not available for all countries covered in the study, we use wage dispersion between the lowest and highest decile of the earnings scale as an additional indicator for income inequality (albeit this only reflects the income distribution before taxes and transfers).

The overall picture that emerges in these four tables in the immense difference in performance across different countries in each of these dimensions. With respect to macroeconomic performance, especially in terms the rankings that we supply, the picture is very mixed. The cross-national rankings is clearly dependent on the selection and the relative weight of the different indicators, which is especially true with respect to New Zealand and Australia.

With respect to employment performance, Table b also reveals important differences. National employment records display a span in employment/population ratios from 78.1% for Switzerland to 50.5% for Italy and in unemployment ratios from 4.2% in Switzerland to 12.4% in France. Cross-national differences are even more pronounced with respect to the level of long-term unemployment. The relative ranking of countries along the dimension of employment performance shows two substantial findings: Not surprisingly, those countries which display an employment performance significantly below average (Germany, Belgium, France and Italy) are welfare states of the continental regime type, combining a modest level of both public and private employment which may be interpreted as a result of a strategy to reduce labour supply and of a strong reliance on payroll taxes crowding out low-paid employment in the sheltered sector. This is also brought out in the benefit dependency ratio, which reveals the poor performance of Belgium, France, and, most interestingly, Austria, which has one of lowest rates of unemployment. Although these countries all belong to the family of continental welfare state, this is not to say that continental welfare states per se are unable to escape the 'inactivity trap'. The Netherlands is a continental welfare model that has been able to reverse the inactivity trap. The Netherlands is actually the only country in our ranking (see figue xy) for which

the benefit dependency ratio in the mid-1990s is more favourable than in the early 1980s. This shows that the continental dilemma of "welfare without work" is not inevitable.

With respect to levels of social protection we again continue to observe tremendous cross-national variation. By and large our table still confirms a picture of very different welfare regimes along the lines developed by Esping-Andersen. Denmark and Sweden still appear as the most generous welfare states with very high spending levels for social services. The continental welfare state remain at intermediate levels of generosity and clearly spend less in social services than their Nordic counterparts. At the lower end of the scale of social protection we find the lean liberal Anglo-Saxon welfare states.

Welfare state generosity is also reflected in the redistributive performance of the welfare state. The Anglo-Saxon countries display not only high levels of wage dispersion, but also comparatively high poverty rates and a comparatively inegalitarian distribution of disposable household income (measured by the Ginin-coefficient). The continental welfare states are by and large to be located in the middle range, displaying a medium performance in terms of redistribution. However, within the sample of continental welfare states, the spectrum is wide. Italy, with average levels of wage dispersion, reveals strong disparities in terms of post-tax and transfer income distribution and poverty. This should perhaps be interpreted as a consequence of its pension-heavy and clientelistic and insider-biased welfare state and the lack of an adequate safety net for the outsiders. On the contrary, Belgium and the Netherlands, albeit belonging to the continental group, reveal a comparative favourable performance in all three dimensions, coming pretty close to the Nordic welfare states in terms of redistributive performance. It should however be noted that some increase in inequality has accompanied the Dutch miracle.

8.4 Different strategies for successful adjustment

The performance tables reveal that relatively successful employment policies are possible under very different welfare state arrangements. The United Kingdom, the Netherlands and Denmark, coming from different worlds of welfare capitalism, are cases in point

(Esping-Andersen 1990). While the United Kingdom is to be characterised as a liberal type of welfare regime, and the Netherlands are best described as a continental-type of welfare state, Denmark must be counted as a representative of the social-democratic model. Nevertheless, they all display good employment performance: Overall employment levels have increased disproportionally during the last years and are at present above the international average, especially in the United Kingdom and in Denmark, whereas unemployment ratios have at the same time fallen substantially and are currently rather low in all three countries[3]. Moreover, levels of long-term unemployment could still be reduced significantly in these countries since 1994. Female employment in the Netherlands is still below the average, but has grown significantly over the past decade, and has thereby outpaced Belgium and Italy. Female employment ratios in the United Kingdom and Denmark clearly exceed the average. Relative rates of youth unemployment are well above the average unemployment rates of the three countries, but still significantly better than most of the other countries in our sample, except for Austria, Germany, and Switzerland. As already mentioned above, the favourable employment performance of these countries also applies to benefit dependency ratios[4].

To be sure, the favourable high employment performance should in part be attributed to favourable macro-economic conditions: Between 1994 and 1997 their average rates of economic growth were between 0.5 and 0.9% above the average in our country sample, while (except for the United Kingdom) inflation could be kept at a medium level (see table a). The record of the United Kingdom becomes even more mixed when we take into account the structural deficit, which is clearly above the international average.
How do we explain the fact, that positive employment performance can be achieved in different types of welfare state regimes? Our argument is, that the basic requirements for a successful employment policy can be met by different policy strategies, as long as they display some measure of 'goodness of fit' with the existing welfare state arrangements,

[3] To be sure, the level of employment performance is also still comparatively high in Austria and Switzerland, but (in contrast to Denmark, the Netherlands and the United Kingdom) they display a declining trend in employment performance in the 1990s.
[4] To be sure, the relative position of countries with respect to employment performance is highly dependent on the indicators which are used and the relative weight given to them. However, labour market and unemployment performance rankings in the recent Joint employment report from the European Commission (1998) confirms our

and that this can to go hand in hand with a rise in social exclusion, but not necessarily so (see table xy).

Table xy: Patterns of successful employment policy

Requirements	United Kingdom	Denmark	Netherlands
Wage restraint + Flexibility at the micro-level	Union bashing Decentralization	Two-level bargaining	Two-level bargaining
Expand low-paid employment	Lower social assistance and unemployment benefit level Reduced social contributions at the lower end of the earnings scale	Traditionally low tax wedge at the lower end of the earnings scale	Reduced social contributions at the lower end of the earnings scale Lowering the minimum wage
Labor market flexibility	Radical deregulation and privatization	*Desegmentation*: Low employment protection + generous unemployment benefits Stricter job suitability criteria for the unemployed + ALMP	*Desegmentation*: High level of part-time and temporary work + generous basic pension Stricter job suitability criteria for the unemployed + ALMP

assessment that Denmark, the United Kingdom and to a lesser extent the Netherlands are among the better performers.

What all three countries share is high levels of part-time work, which seems to have helped both in terms of increasing employment and reducing unemployment. The Netherlands has the highest share, followed by Denmark and the UK (defined as those working less than 30 hours). In the Netherlands almost 36 percent of the work force work part-time, 22.2 percent for the UK, 21,5 percent in Denmark. In general part-time work is strongly gender-biased. Mostly women hold part-time jobs, 65 percent in Denmark, 75% in the Netherlands, and ... in the United Kingdom. In the Netherlands women and increasingly men prefer to work part-time. Empirical evidence show that most fixed-term contracts are in due course transformed into more fulltime positions. Especially for young people it may serve as a bridge into regular employment (Auer, 1998).
The high part-time employment ratios in these three countries suggests that there should be substantial room for expanding part-time work in other countries. As part-time work is usually connected with reduced gross wages, the propensity for individual working time reduction might be increased by a lowering of the tax burden to partly compensate the loss in net wages. Moreover, working-time reduction should be coupled to an increase in working time flexibility as this allows for a better use of capacities at the firm level and a better fit to employees needs. Measures of working-time reduction should not be connected with elements of wage compensation, which would drive up labour costs. Finally, there is reason to assume that voluntary reduction of individual labour time have less negative side effect in so far that they prevent evasion strategies of employees and firms, leading to an expansion of the grey economy. If it is true that part-time work could be important for job growth, then raising the status of part-time work through legislation is crucial (see Walwei 1998).

A major difference in the national employment systems emerges, for instance, if we compare the shares in public employment: With public employment ratios of 9.5 and 6.8%, respectively, the United Kingdom and the Netherlands display comparatively modest levels of public employment (whereby the figures for the Netherlands are somewhat underestimated, since they do not include employment in private non-profit institutions). In contrast, the very high levels of total employment in Denmark can be

attributed to the big public sector which employs about 22.7% of the working-age population (OECD 1998, Statistical Compendium/Economic Outlook, own calculations). Another difference refers to the area of labour market regulation, where there is a large gap between the United Kingdom on the one side, and the Netherlands and Denmark on the other. The British labour market is to a high degree based on market principles displaying only a low level of state intervention. The power of the trade unions has been seriously dismantled under the Thatcher government. With the weakening of the bargaining power of the trade unions, together with the rise in unemployment, inflation was brought down dramatically (from 18 to 3,4 percent between 1980 and 1986), and wage dispersion increased significantly in the 1980s and 1990s. By the same token, the level of dismissal protection is low by international standards. Wage bargaining is highly decentralized which makes a co-ordination of wage bargaining extremely difficult and issue-linkage between wage policy, social security policy and labour market policy, practically impossible. Moreover, spending on active labour market policy is rather limited by international standards. By and large, British labour market policy could be characterised as pursuing a „low wage/low cost“ strategy, aimed to achieve international competitiveness by extensive deregulation and welfare state retrenchment rather than by increasing productivity and wages through investments in human capital[5].
In contrast we see a higher level of regulation in the Dutch and the Danish labour market. Their systems of industrial relations are marked by a low intensity of industrial conflict (in comparison to the UK) and a high degree of consensual decision-making and policy concertation in wage negotiations between the state and the social partners. Both countries have developed a system of wage bargaining which could be labeled as „organized decentralization“ (Netherlands) or „centralized decentralization“ (Denmark), which have so far been quite successful to combine moderate wage increases with a high level of flexibility at the micro-level. Nevertheless, the level of wage dispersion is still comparatively low both in Denmark and in the Netherlands. Moreover, spending on active labour market policy was substantially raised during the last years and is currently higher than in most other countries, especially in Denmark.

[5] Note, that the British productivity level in manufacturing is about 45 percentage points below the Dutch and still 21 percentage points below the Danish level (Institut der deutschen Wirtschaft Köln 1999, Internationale Wirtcshaftszahlen).

Policy concertation also allows for substantial measures of issue-linkage between the policy areas of industrial relations, social security and labour market regulation. With respect to the strong coupling between the spheres of labour market regulation and social security, the Dutch and the Danes seem to pursue conscious strategies of labour market desegmentation, for which the term „*flexicurity*“ has been coined in the Netherlands. Labour market desegmentation is geared towards a negotiated relaxation of employment protection for the stable, full-time, core workforce which is coupled to increasing protection for peripheral, unstable, part-time and temporarily employed in the rest of the economy. This then thwarts the growth of large sector of precarious jobs, which is prevalent in especially Spain, but also France. As such, 'flexicurity' pacts aim to bridge the preferences of flexibility of employers and stability and security on the part of workers, and thus making labour market flexibility more socially acceptable. This, in part, explain why part-time employment is pretty high in both countries, and, especially in the Netherlands, generally aspired to by women and increasingly men. The popularity of part-time work in the Netherlands is closely related to the presence of a basic-pension system and a partial individualization of social security entitlements, making a reduction of individual working-time more attractive than in countries with a purely earnings-related pension system, such as Germany, where part-time employment leads to a proportional reduction of pension payments. The Danish welfare state is a de facto flexicurity regime: Very high levels of unemployment benefits make employees and trade unions more prone to accept the weak protection against dismissals. Evidence from Spain and Italy suggest that social protection and dismissal protection are functional equivalents. Weak social protection goes together with tough dismissal protection and vice versa. What is important, however, is that dismissal protection essentially caters after the interests of the insiders, whereas social protection is also geared towards outsiders. In this respect a 'flexicurity' regime is clearly normatively superior to its functional equivalent in segmented labour markets. A strong element of labour market desegmentation is also dominant in the field of labour market policy, where a broad range of activation programs is combined with a high pressure on the unemployed to accept job offers and education entitlements. Also the demonopolization, decentralization and regionalization of the Public Employment Service together with the increased scope for private placement through temporary job agencies

can be subsumed under the heading of flexicurity, and has a much wider reference beyond Denmark and the Netherlands.
The policy of labour market desegmentation, as it seeks to reconcile superior employment outcomes with high standards of social protection for everyone, stands in sharp contrast the British strategy of deunionization, curtailing collective bargaining coverage, that was popular under the Conservatives. By contrast, the Netherlands and Denmark show, that a successful employment policy is possible without a dismantling of the welfare state, as this did in part take place in Great Britain. While social expenditures as a share of GDP are comparatively high in Denmark and - to a lesser degree- in the Netherlands, they are relatively low in the United Kingdom by international standards. A similar pattern can be identified with respect to the level of unemployment and social assistance benefits. Another cornerstone of the Dutch strategy of flexicurity revolves around the partial shift of financial responsibilities within the system of social security to individual firms and employers, for instance for the first year of sick pay, which gives them an incentive to reduce absentism through improvement in the organization of work.

Based on these three patterns of successful adjustment, we allow ourselves to speculate about the policy options for a both employment-friendly and equitable welfare state. We argue that the degree of positive policy coordination is essential, both between and within policy areas, as well as between political actors. From the point of view of *economic* effectiveness, one might, as OECD economists do, argue that a comprehensive reform package is desirable, as it aimed to avoid negative spillover effects and externalities among different policy areas. However, given the fact that policy adjustment is fundamentally a political process, there is much to be said for an incremental approach to welfare reform for a number of obvious reasons. First, attention spans of policy makers are short and focus mainly on politically salient area specific problem constellations, ranging from industrial decline to budget deficits and the problem of the decline in the demand for labor of low-skill workers. These shifts in policy attention very drive the policy process. Second, as patterns of industrial relations, programs of social security, and labor market regulations are build on social and economic rights, any form of adjustment is likely encounter political opposition by those who have been granted these right. From this

it follows, that any attempt to curtail these rights all at once will most likely result in large scale protest which may undermine the reform effort. Third, as we have already highlighted, many of the policy areas at stake are not under full substantive and administrative control by any government. Often policy making authorities are shared between state officials and the social partners, which again constrains the political degrees of freedom for the government. Especially those polities which are run by coalition governments and where non-state actors have policy making authorities are, institutionally speaking, 'negotiating' political systems, for which coordinated change is the only viable route of policy adjustment. Finally, in terms of policy implementation the involvement of non-state actors which preside over local sector-specific information and expertise can be useful for policy makers. Moreover, pooled policy authorities can encourage a cooperative style of non-state actors which are likely to be able to guarantee voluntary compliance to negotiated agreements of their rank and file. For reasons of *political* viability and based on empirical evidence, excepting the unitary-majoritarian political systems of the United Kingdom and New Zealand, we tend to plead for a strategy of sequential and coordinated policy change, which allows for temporal learning and incremental adjustment.

The advantage of this type of temporal policy coordination is best be illustrated by the varying degrees to which countries have been able to organize a smooth interplay between wage, monetary and fiscal policy. Within a framework of tightly-coupled systems of social and economic regulation a successful employment strategy a set of co-ordinated and well-timed measures across various policy areas, hoping to reduce negative spill-over effects from one policy area to another (which are more likely to occur in a system of segmented political decision-making). This type of policy concertation which experienced a second youth in the 1980s and 1990s differs from Keynesian corporatist incomes policy of the 1970s, insofar as it is geared towards an improvement of supply-side conditions covering a broad range of areas such as social security reform, labour market regulation, employment protection, vocational education and training and gender issues (rather than pure demand management and redistributive policy). Austria, Denmark, Italy and the Netherlands are cases in point. Attempts in this direction were undertaken also in Belgium and Germany, but were not successful.

Such an coordinated approach is critically dependent on a range of institutional prerequisites. Not only have political actors to develop a common understanding of both the problem constellation and the policy solutions which are required. Given the self-interest and the bounded rationality on the side of the political actors, this cannot be taken for granted. Here, the role of common fora that bring the social partners and state officials together, is crucial. In these fora social dialogue can take place which can lead to the formation of a joint utility function for tackling the problems at hand. Any joint utility function critically relies on transparent, generally accepted facts. Only on the basis of these commonly accepted information can the different actors develop viable policy solutions. Moreover, repeated encounters enables policy actors to come up with acceptable solutions for distributive problems as they allow unfair outcomes to be corrected in successive rounds of negotiations, thereby economizing transaction, negotiation and monitoring costs. This type of issue-linkage between the production problem (the search for "good" solutions) and the distributive problem (the choice of the solution that is best for their own side), if successful, promotes mutual trust and commitments within the institutional forum. The availability of trustworthy information, however, is critically dependent on the relative coherence of economic expertise. A condition whereby five major economic institutes are the key providers of expert information (which is, for instance, the case in Germany) can easily lead not only to rivalry between the institutes but, more important, it can engender strategic "misuse" by interested parties in negotiations which is likely to undermine trust between the relevant actors thus impeding the emergence of a common problem understanding.
The policy actors also need the political power to enact their commonly agreed to policies. The capability of central governments to enter into a strategy of political exchange with the social partners by offering package deals across different policies is particularly important since the realization of coordination gains is critically dependent on the capacity to compensate potential losers by the delivering of side payments in a situation of distributive bargaining (see Scharpf 1997:126ff.). Wage negotiations are a case in point. In order to generate positive employment results, they have to serve a double function. First, they should prevent wage inflation, secondly they should allow for a sufficient flexibility at the micro-level. The first goal could theoretically be reached by government intervention (if

there is no legal constraint by the principle of *Tarifautonomie*), which was by instance frequently applied in France. The second goal definitely requires a high degree of informational resources, which only the social partners can provide thereby help to unburden the state from regulatory overload. This mechanism is clearly observed in the Belgian case, where the failure to reach a negotiated agreement forced the state to impose wage restraint with the effect of undermining micro-flexibility. Thus, leaving the British strategy of union bashing aside, in order to realize a combination of wage restraint *and* wage flexibility, the approval from the social partners is required. This approval, however, is more likely to be reached, if the government is able to deliver side payments, by instance through exchanging wage restraint against an extension of social benefits or tax relieves and the like. While this is easier in a more unified governance structure, it is far more difficult in a vertically and horizontally fragmented governance structure, which offers a multitude of veto-points for various interest groups to obstruct political reform. For instance, in Germany the fiscal interests of the *Länder* are institutionally mediated into the federal level by the *Bundesrat*, which restricts the institutional capacity of the government to pursue a coherent tax policy, which would make it easier for the social partners to accept wage moderation (a type of "issue-linkage" for which the Netherlands are a good case in point). If the party system within such an institutional arrangement is highly competitive the potential for a construction of encompassing package deals will be even more limited.

A further institutional constraint refers to the system of industrial relations and the associational capacity of unions and employers. For instance, the strategic action of the social partners is only likely to result in positive-sum games if the size of trade unions and employer organizations exceeds a critical limit, above which they cannot fully externalize the negative consequences of their decisions. The failure of the British „Social contract" is a case in point here. Moreover, in bargaining constellations, which resemble a „Battle-of-the-sexes" game, the realization of co-ordination gains requires the transformation of short-run self interests into solidaristic orientations of interaction on both sides and a shared view of the dominant problem constellation. It is hardly a chance, that two of the most successful countries in our study, Denmark and the Netherlands, also faced the most severe economic crises in the early 1980s, which fostered a process of fundamental

policy learning and a running of existing blockades for policy reform. Similarly, the recent change of the political system in Italy has to be seen against the background of a widespread and deep crisis awareness.

Even if the potential and the willingness for a strategy of positive coordination is given, there is no *guarantee* that the political actors make the right decision and that the content of policy responses is suitable for the solution of the employment problem in the context of international economic constraints. Therefore we also have to ask what the substantial "ingredients" for a successful employment policy are. The national experiences reported in this study, suggest that some fundamental interdependencies have to be taken into account:

First, spending on social security is not only to be regarded as a mere cost factor hampering business in international competition. Social security arrangements may well play a supportive role for the economy as a whole. We argue, that it is the structure of social spending rather than the level which affects its economic impact. For instance, the intense spending on social services in the Scandinavian countries generating the reproduction of care and education is arguably more productive than mere income maintenance programs concentrated on the aged as it is especially the case in Italy (Stephens, forthcoming). Moreover, the welfare state serves as an automatic stabilizer in periods of low economic growth. Finally, its crucial role in maintaining social stability must not be underestimated.

First, a stable macro-economic policy is clearly an important precondition for high economic growth and positive employment results. High public deficits and high inflation rates are in the long-run not compatible with globalized financial markets. By the same token, if the structural budget deficit is low on average, there will be some leeway to activate the stabilizing function of fiscal policy in periods of low economic growth. The Danish tax reform of 1994 is a case in point, insofar as the comparatively low structural budget deficit allowed for a temporarily underfinanced tax reform that helped to stimulate the economy in a period of low growth. In the Netherlands successful combination and coordination of macro-economic, fiscal and wage policy helped to restore and further confidence in the economy, thereby reducing hesitancy on the part of potential investors and stimulating consumer demand, after the mid-1980s and throughout the 1990s.

Moreover, since strategic devaluations are no longer viable, a moderate wage policy has become the primary tool for maintaining international competitiveness. However, long-term wage restraint seems also to stimulate employment growth in the sheltered sector. Moreover, there is some empirical evidence that wage restraint allows for a smoother interplay between wage, monetary and fiscal policy stimulating economic growth and keeping inflation low. The Danish and the Dutch case suggest, that two-level wage bargaining systems are comparatively successful in combining wage moderation and wage flexibility at the micro-level.

Secondly, the financing structure of the welfare state has an immediate impact on employment levels at the lower end of the earnings scale. Social security systems which are financed out of payroll taxes tend to increase labour costs for low-paid employment above the corresponding productivity levels, if wages are downwards sticky. A substantial reduction of social contributions for low-paid workers, as was undertaken for instance in the Netherlands and in the United Kingdom, could be the right strategy to resolve this dilemma.

Thirdly, the continental strategy of labour supply reduction is a dead-end street, since increasing inactivity rates tend to aggravate the financial burden imposed on the active part of the population. It is not that we argue against temporary reductions in labour supply as an additional strategy. But such solutions, as we know, have a tendency to become permanent. The Danish leave schemes for sabbatical, educational, parental leave are more appropriate measures for temporary labour supply reduction in the context of low economic growth than the continental strategy of permanent labour shedding. A combined strategy of limiting the exit-options from the labour-market, for instance through more gradual retirement schemes, allowing the elderly to work part-time, increasing the activation content of labour-market policy and strengthening the work incentives for the unemployed seems to be the most effective approach to increase employment and to lower the financial burden caused by inactivity. Paid leave schemes and active labour market policies may be regarded as 'transitional labour market state' serving in part as 'buffer zones' around the regular labour market, while containing hysterisis effects and tendencies towards social exclusion caused by long-term unemployment (Auer, 1998; Schmidt, 1996).

With respect to pensions, there are reasons to believe that countries with a three-tiered pension system (such as in the Netherlands and Switzerland), combining different modes of financing (leading to a mixture of pay as you go and private and public funding elements) are comparatively robust in their revenue basis.
To sum up, there is, neither from a theoretical nor from an empirical point of view, much reason to believe, that a high level of social security necessarily has negative impacts on macro-economic and employment performance. The national experiences reported in this study suggest, that a coordinated policy approach geared to a combination of moderate wage policy, a flexible labor market and a high level of social protection is the most promising way to meet both the requirements of the market and the policy commitments on which the welfare state is built up.

We have highlighted the broad variety of combinations of different policy choices across many policy areas, that are still economically feasible and politically viable within the corridor of possible policy responses constrained by the dialectic interplay of economic internationalization and historically established domestic policy regimes.

Table a: Macro-economic performance (1994-97)

	GDP growth	Inflation	Structural balance 1997	Current account balance	*Performance (a) (including current account balance)*	*Performance (b) (excluding current account balance)*	*Performance (c) (GDP per capita in 1996, OECD = 100)*	*Ranking in performance*		
								(a)	*(b)*	*(c)*
DK	3,4	2,1	-0,1	1,2	*2,4*	*1,2*	*110*	***5***	***4***	***2***
B	2,2	1,9	-0,7	5,4	*5*	*-0,4*	*108*	***3***	***5***	***3***
NL	3,0	2,3	-1,3	6,1	*5,5*	*-0,6*	*103*	***1***	***6***	***6***
CH	0,5	1,0	-1,5*	7,3	*5,3*	*-2,0*	*125*	***2***	***10***	***1***
S	2,6	1,8	0,6	1,9	*3,3*	*1,4*	*95*	***4***	***3***	***10***
NZ	3,7	2,3	1,8	-4,4	*-1,2*	*3,2*	*86*	***8***	***1***	***12***
AUS	4,0	2,4	0,2	-4,5	*-2,7*	*1,8*	*100*	***11***	***2***	***8***
F	2,2	1,7	-1,7	1,4	*0,2*	*-1,2*	*101*	***6***	***8***	***7***
A	2,1	2,1	-1,1	-1,7	*-2,8*	*-1,1*	*105*	***12***	***7***	***4***
D	2,0	2,0	-1,8	-0,6	*-2,4*	*-1,8*	*104*	***10***	***9***	***5***
I	1,8	3,7	-1,7	2,6	*-1*	*-3,6*	*98*	***7***	***12***	***9***
UK	3,1	2,9	-2,2	-0,1	*-2,1*	*-2.0*	*92*	***9***	***10***	***11***
Aver.	**2,5**	**2,2**	**-0,8**	**1,2**	***0,8***	***-0,4***	***102***			

(a) Performance = GDP growth – inflation + structural balance + current account balance
(b) Performance = GDP growth – inflation + structural balance
(c) In PPPs
* estimation
Source: OECD; own calculations

Table b: Employment performance 1997

	(1) Employment ratio (a)	(2) Unemployment ratio (b)	(3) Long-term unemployment (c)	*Performance-Index: (1)-(2)-(3)*	*Ranking*	Female employment ratio (1996)*	Youth unemployment (15-24 years)*	Inactivity/ Activity ratio° (1996)
CH	78,1	4,2	1,1	*72,8*	***1***	65,2	4,9	
DK	75,4	5,5	1,5	*68,4*	***2***	67,7	10,6	0,402
A	67,2	4,4	1,0	*61,8*	***3***		6,9	0,593
UK	70,8	7	3,0	*60,8*	***4***	62,2	14,7	0,422
NL	67,5	5,2	2,5	*59,8*	***5***	53,4	12,1	0,394
S	70,7	9,9	1,5	*59,3*	***6***	68,2	15,7	0,401
NZ	65,4	6,7	1,6	*57,1*	***7***	62,9	11,7	
AUS	66,3	8,7	2,9	*54,7*	***8***	59,5	14,8	
D	63,5	10	4,5	*49,0*	***9***	55,1	8,0	0,425
B	57	9,2	5,4	*42,4*	***10***	46,3	20,5	0,665
F	58,8	12,4	4,8	*41,6*	***11***		26,3	0,502
I	50,5	12,1	7,5	*30,9*	***12***	36,0	32	
Aver.	**65,9**	**7,9**	**3,1**	***54,9***		**57,7**	**14,9**	**0,476**

(a) Total employment/Population 15-64 years
(b) Standardized ratio
(c) Long-term unemploymed (12 months and over) as percentage of labour force
* or last year available
° for population aged 15-64 years
Source: OECD 1998, Schröder/Suntum 1998; SZW; own calculations

Table c: Level of social security

	Social expenditure ratio 1995*	Social transfers			Social Services	
		Public Pensions: Implicit Replacement rate (a)	Net replacement rate in unemployment benefits 1995 (b)	Level of social assistance in PPPs, 1992 (c)	Elderly and disabled services as % of GDP (1995)	Family services as % of GDP (1995)
S	33,4	54%	81%	124	3,37	1,72
DK	32,6	40%	83%	129	3,04	2,10
F	30,1	56%	82%	96	0,78	0,37
D	29,6	46%	75%	95	0,58	0,78
B	28,8	63%	71%	88	0,15	0,13
NL	28	39%	83%	133	0,67	0,36
A	27,1	40%	66%	98	0,36	0,49
CH	25,5	n.a.	78%	141	0,47	n.a.
I	23,7	49%	42%	128	0,20	0,10
UK	22,8	23%	68%	111	0,68	0,48
NZ	18,8	51%	59%	82	0,05	0,09
AUS	15,7	30%	59%	128	0,35	0,21
Aver.	**26,3**	**45%**	**71%**	**113**	**0,89**	**0,62**

* Total social expenditures as a share of GDP (before taxes, including private mandatory benefits)
(a) Ratio of average pensions to average wages
(b) Net replacement rates after tax; average for four different family types and two earnings levels; including unemployment benefits, family, and housing benefits in the first month of benefit receipt; it is assumed that waiting periods are met
(c) OECD mean = 100, average for different family types, after housing costs
Source: OECD; Gern 1998; own calculations

Table d: Income inequality

	Wage dispersion D9/D1 (c, 2)	Gini-coefficient (b)	Poverty rate (a)
S	2,1	22,9 (2)	7,3 (2)
DK	2,2 (1)	24,0 (2)	6,9 (2)
B	2,3	23,0 (2)	5,5 (2)
D	2,4	25,6 (0)	11,4 (2)
NL	2,6	27,2 (1)	6,2 (1)
CH	2,7	n.a.	n.a.
I	2,8	34,6 (2)	12,8 (2)
AUS	2,9	31,7 (2)	9,2 (1)
NZ	3,1	n.a.	n.a.
F	3,3	32,4 (1)	15,9 (1)
UK	3,3	34,6 (2)	10,6 (2)
A	3,6*	n.a.	n.a.
Aver.	**2,8**	**28,4**	**9,5**

(a) % below 50% of Median
(b) Lower figures indicate a more egalitarian structure of distribution of disposable income
(c) D1 refers to the lowest income decile, D9 refers to the highest income decile
(0) 1983-87
(1) 1988-91
(2) 1992-95
* figures for A are overestimated due to the inclusion of part-time workers
Source: OECD; LIS; own calculations