European Social Models from Crisis to Crisis

Employment and Inequality in the Era of Monetary Integration

Edited by
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OXFORD
UNIVERSITY PRESS

OXFORD
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Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship, and education by publishing worldwide. Oxford is a registered trade mark of Oxford University Press in the UK and in certain other countries

First Edition published in 2015

Impression: 1

Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data
Data available

Library of Congress Control Number: 2014941217

ISBN 978-0-19-871796-6

Printed and bound by
CPI Group (UK) Ltd, Croydon, CR0 4YY

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11

From Crisis to Crisis

European Social Models and Labor Market Outcomes in the Era of Monetary Integration[1]

Jon Erik Dølvik and Andrew Martin

Our account of the past decades' trajectory of European social models runs between two critical junctures: first, the economic crisis precipitated by policy responses to German unification, when a prolonged recession with high unemployment was triggered by the Bundesbank's drastic tightening of monetary policy, which it effectively set for all of Europe; and second, the Great Recession precipitated by the financial crisis and magnified by Europe's policy responses to the sovereign debt crisis, this time by drastically tightening fiscal policy, with even more devastating social consequences. In the first instance, German policy shaped European developments through the role of the Bundesbank; in the second instance, German policy shaped European developments through its role in institutionalizing a structure of economic governance which lacked the capacity for managing a common currency area without imposing huge social costs in the form of "internal devaluations."

In both junctures, policy responses were focused more on "structural reforms" in social models than on counteracting depressed demand, aggravating unemployment, and straining welfare state finances. As discussed in Chapter 1, the dominant view at the European level was that the job crises were mainly attributable to supply-side dysfunctions of labor market and welfare state institutions (European Commission 1993; OECD 1994). The prescription was, first, to make employment relations institutions more

[1] This chapter draws extensively on the country case studies in Chapters 3–8, which unless otherwise indicated provide the sources for the analyses.

market-conforming by deregulation of hiring and firing and decentralization of wage setting; second, to make the welfare state more "employment friendly" by shifting from passive transfers to activation and strengthening work incentives by recalibrating benefits and taxes so as to "make work pay."

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

To understand how the interplay between changes in social models and economic conditions influenced labor market outcomes in the context of the two crisis periods, this chapter draws on and supplements the case studies to provide a comparative review of the evolution of the social models of our case countries over the past two decades, the political dynamics shaping them, and the patterns of employment and inequality to which they contributed.

11.1. Changing European Social Models

The social model changes in the 1990s and early 2000s were concentrated in three areas. First, in the labor market, employers and governments pushed for wage restraint and more flexibility in employment relations and collective bargaining. Many governments tried to lower entry barriers in the labor market by liberalizing employment protection on the margins. Second, in the welfare state realm, efforts were made in most countries to save costs and increase revenues through stronger emphasis on activation, training, and work. Third, such efforts to boost employment were complemented by expanded education and upgrading of workforce skills. During the Euro-crisis, there were clear continuities with respect to the direction of change—emphasizing "structural reform" of labor markets and the welfare state—but the combination of financial turbulence and supranational demands gave rise in several instances to much more drastic changes than those seen in the preceding decades. This section reviews the main lines and variations of change prior to and during the crisis.

11.1.1 *Activating the Welfare State*

The rationale for efforts to make the welfare states more "employment friendly" was that it would generate double gains: first, increased labor market participation and revenues; second, fewer benefit receivers and reduced spending on passive transfers. Premised on the view that the welfare state had impaired incentives to work, especially for groups threatened by marginalization—typically low-skilled, lone parents, and elderly labor—activation was sought through stricter conditionality and recalibration of benefits. Early retirement schemes were phased out, though less in Italy, France, Finland, and Denmark than elsewhere. Pension reforms were enacted at varying rates, relying on strengthened ties to contributions and adjustment of retirement age and compensation levels to longevity, often supplemented by establishing universal minimum protection funded by taxation. In countries where earlier attempts to change pension systems had been stalled—such as France, Italy, and Finland—a second wave of such reforms was eventually prompted by the Great Recession alongside further increases of the retirement age in other countries.

The rhetoric of activation was embraced everywhere but, depending on variation in pre-existing transfer systems—and budgetary leeway—its actual application varied substantially. Differences in the stringency of activity requirements and the emphasis on skill formation gave rise to distinctions between British-style "work first" strategies and Nordic-style approaches emphasizing social investment (Esping-Andersen 2002). Besides the unemployed, the requirement to participate in activation programs was increasingly also applied to recipients of social assistance, lone mothers, the disabled, and other groups. Except in Spain and Italy, which tried to upgrade their rudimentary systems, eligibility criteria, duration, and compensation levels in unemployment benefit schemes were tightened—most conspicuously in the German Hartz IV reform implemented in 2005. Hence, the share of unemployed receiving benefits was reduced, not least among the rising shares of temporary workers (OECD 2011a: 292–93). When the financial crisis burst, such previous adjustments often aggravated the social and distributive consequences and weakened the automatic stabilizer function of the welfare system. In response, several countries temporarily loosened eligibility criteria, and Italy added new layers to its patchy unemployment benefit system. Denmark, however, halved benefit duration from four to two years, and tightened requalification requirements in the midst of the crisis.

In many countries, the strengthened emphasis on activation was considered complementary to partial deregulation aimed at making labor markets more accessible. The anticipation of double gains also made several governments willing to lower indirect labor costs for employers hiring job seekers with limited employability. While offering employers reduced social security contributions for special categories of workers or jobs—such as the "mini" and "midi" jobs in Germany, and new entry jobs in other countries—workers accepting low-wage jobs were offered various kinds of tax deductions, earned income-tax credits, and other in-work-benefits.[2] Aimed at making people employable by adjusting their skills and aspirations to the actual demand for labor, the activation turn implied a re-commodification of labor. Combined with deregulation of the parts of the labor market where most participants were likely to be activated—in the 2000s framed by the notion of "flexicurity"—these changes entailed a dual movement whereby re-commodification was associated with a stronger state hand in restructuring the labor market—especially its periphery. The emphasis on conditionality and individual differentiation also implied that the rights of clients became subject to discretionary judgment—allowing more unequal treatment—amounting to a transformation of the notion of social citizenship, especially in the status-preserving Bismarckian systems in Continental countries (Betzelt and Bothfeld 2011; Hemerijck 2013).

While activation seemed instrumental in promoting employment during the boom in the 2000s, the contraction of labor demand during the crisis made "job first" approaches less relevant, leading the OECD to recommend a turn toward education, training, and conventional ALMP to prepare the unemployed workforce for a future recovery (OECD 2010a; 2011f). However, given the drains on public purses and the subsequent EU shift to austerity policies, the resources for such investments were severely limited in many countries, widening the gap between capacity and needs. There was thus very little connection between the actual development of unemployment and changes in the share of GDP spent on active programs during the crisis (OECD.stat). All the case countries except Italy increased spending in 2009–10, but when the EU turned to austerity in 2011 all countries cut spending on active programs (save for Denmark). At the low end, the UK and Italy spent 0.7–0.8 percent in 2011—an actual decrease in Italy—while Denmark at the other end doubled its spending and used almost twice as much as any other country (2.3 percent).

A central aim of the social model changes from the 1990s onwards was to curb the rise in public social expenditure. In Figure 11.1 our case countries are ranked according to public social spending relative to GDP at the brink of the crisis in 2008. In the 15 years prior to the crisis, most of the countries with strong economic performance[3] saw a reduction or flattening of social

[2] Such benefits are expected to boost employment in low-wage firms, by setting the reservation wage below that set by conventional benefits.
[3] National growth figures are shown in Figure 11.6, p. 358.

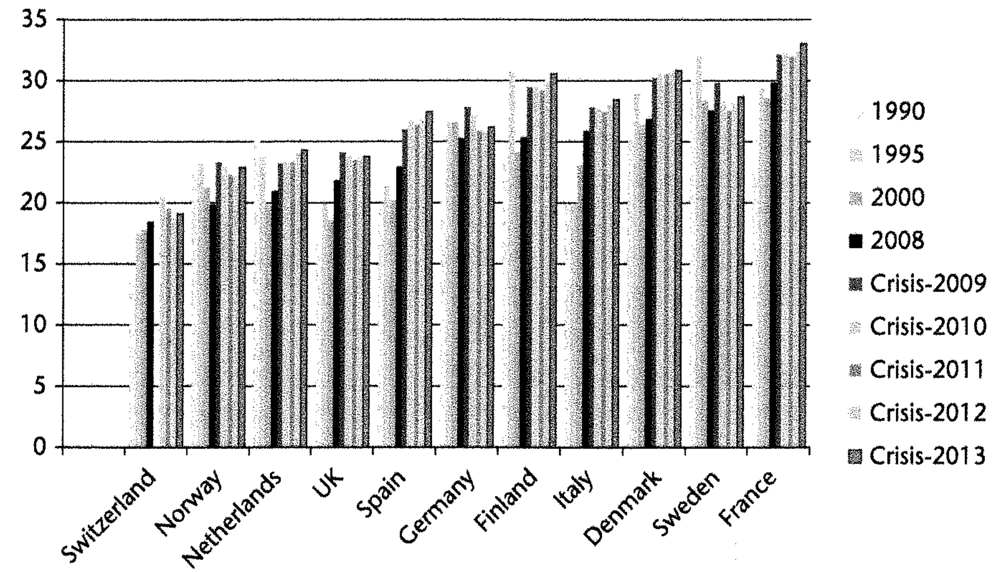

Figure 11.1 Public social spending as share of GDP 1990–2013, ranked by shares in 2008
Source: OECD.stat

spending—the exceptions being Spain and the UK—while social spending rose significantly in the large Eurozone economies with weak growth. The country ranking by 2008 indicates no clear relationship between the size of the welfare state and their fate during the subsequent Euro-crisis. In 2008, hard-hit Spain belonged to the group with modest social spending shares, as did the UK and the Netherlands, while Italy was just above the middle at a level comparable with Germany. By contrast, Denmark and France, with big welfare states, were not hit by the sovereign debt crisis in spite of severe recessions.

A similar pattern emerges from the development of public budget balances and debt (Figure 11.2). Countries with solid growth and employment performance, such as the Netherlands, the Nordic countries, and the UK, moved swiftly from sizable budget deficits after the ERM crisis to surpluses by 2000—followed by Spain in 2005—with all except the UK[4] showing low and falling public debt prior to the crisis. By contrast, countries with sluggish economic and employment growth, such as Italy, France, and Germany, struggled with persistent deficits and had the highest debt ratios among our cases by 2007.

[4] The UK partly financed increased expenditure on social services through borrowing in the 2000s.

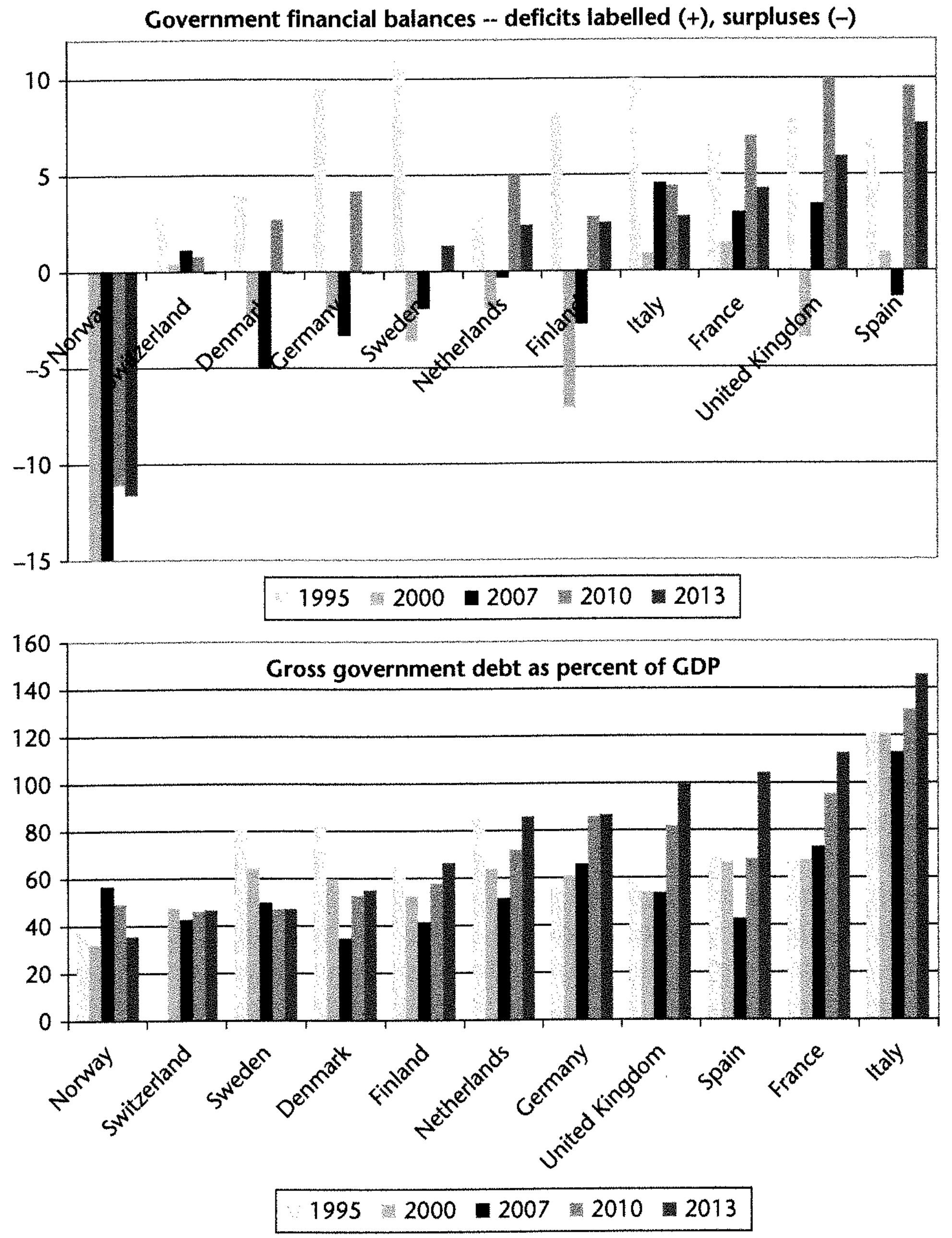

Figure 11.2 General government budget deficits and gross debt as percent of GDP 1995–2013, ranked by 2013 scores
Sources: OECD.stat, OECD Economic Outlook 2014

During the crisis, the social spending share of GDP jumped everywhere in the first phase when the GDP drop was strongest and the automatic stabilizers were allowed to work. However, when the crisis dragged on and the countries tried to adhere to the EU call for fiscal consolidation the social spending share

flattened, and in 2011–12 it declined significantly in real terms—among our cases most pronouncedly in Italy and Spain (Bontout and Lokajickova 2013: 9). Social expenditures also grew much less than under previous recessions (e.g., the 2001–04 downturn), constraining the welfare states' capacity to cushion the social fallout of the crisis (European Commission 2013a: 12, see Section 11.3). This is reflected in the relatively limited changes in budget deficits, which by 2011 had even been reduced in Italy amid the crisis. Besides Spain, the biggest deficit increases came in countries outside the Eurozone, the UK and Denmark, the latter benefiting also from low debt and solid public finances prior to the crisis in spite of its extensive welfare state. While the crisis-induced rises in gross public debt clearly mirrored the bursting construction bubbles and banking crisis, it is notable that the UK showed by far the strongest rise 2007–10. Still, untied to EMU, it was not drawn into the sovereign debt crisis and, like the US, it had little problem financing its huge state debt.

11.1.2 *Upgrading Workforce Skills*

An aspect of the social models that has attained increased attention in recent years is their role in skill formation and education of the workforce (Estevez-Abe et al. 2001). Research findings show that employment prospects and the risk of marginalization are strongly related to education and skills (OECD 2010a; 2013e; Dolton et al. 2009), while the likelihood of successful transition from school to work is closely related to the quality of vocational training (OECD 2009; Busemeyer and Trampusch 2011). All our case countries increased their investment in secondary and higher education in the decades prior to the crisis, a trend which, except in Italy, seemed to continue during the crisis (OECD 2013e).[5]

There was thus a strong rise in the supply of labor with higher education from 1990 to 2007 (Figure 11.3). The growth was strongest in Spain, the UK, the Netherlands, and Norway, while it was weakest in Italy, Germany, and France. Finland stood out at the top, together with other Nordic countries, the UK, and Switzerland. As the upward trend continued during the crisis, and similar rises were seen in upper secondary education, the shares entering the labor market with very low skills (less than upper secondary education) trended downwards—ranging from 8 percent in the 25–34 age group in Sweden and Finland to 28 in Italy and 35 percent in Spain by 2011 (OECD 2013e: 38–39). Norway and Denmark were the only cases where the share of

[5] While the 2005–10 rise in educational spending relative to GDP was strongest in Spain, the level remained lowest in Italy (4.7 percent) and highest in Denmark (8 percent)(OECD 2013e). During the crisis (2008–10) public educational spending increased in all cases, except for a marked decline in Italy.

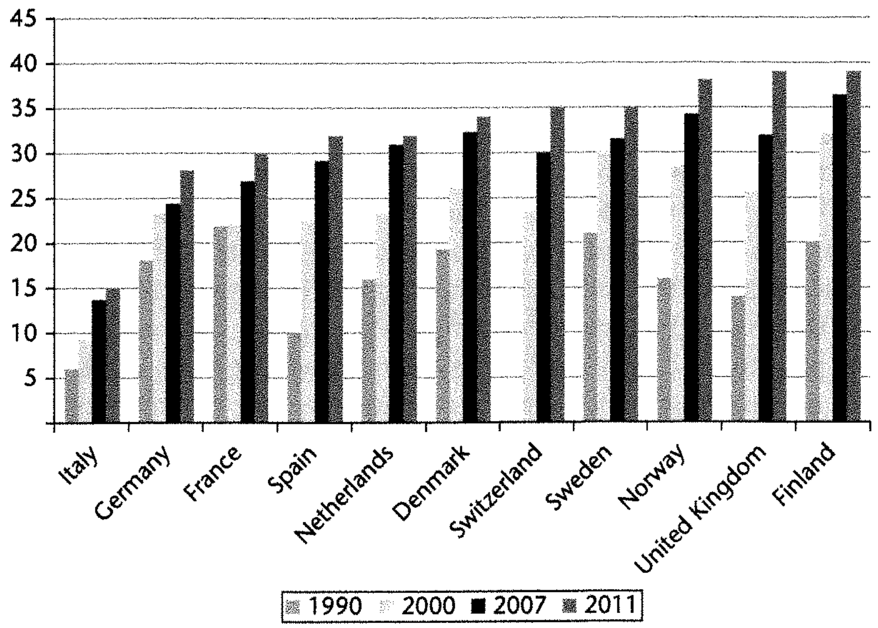

Figure 11.3 Share of adult population (25–64) with tertiary education 1990–2011 (percent)

Sources: OECD Education at a Glance 2009, 2013; Dolton et al. 2009: 3

young adults with low skills increased in the 2000s, presumably reflecting rising drop-out problems among male and migrant students, especially in vocational education.

It is well known that problems with school-to-work transitions and youth unemployment are lower in countries with well-developed vocational education and training systems, in particular those with apprentice-based "dual systems" (Quintini and Manfredi 2009). Among our case countries, this includes Germany, Switzerland, and Denmark, while the others run school-based or mixed systems, as in the Netherlands and Norway (Busemeyer and Trampusch 2011; OECD 2011e). By 2011, more than half of the workforce in Germany had vocational education, contrasted with less than 10 percent in the UK and Spain. However, in recent years, the share of students choosing vocational secondary education fell significantly in Germany, Norway, and Denmark, while an upward trend was seen in the laggard countries in particular. By 2011 it thus varied from 35 percent in the UK to 60–70 percent in Switzerland, the Netherlands, and Finland, where it is also possible to continue into tertiary education (OECD 2013e: 40). Recent evaluations point to strains in most vocational training systems associated with lack of resources, trainers, training places, fragmentation, and declining completion rates,

especially in school-based systems which have been undermined by the rapid expansion of tertiary education (OECD 2011e; Cedefop 2013). Besides France, this has especially been the case in Spain, Italy, and the UK, where workplace training is rare and drop-out rates tend to be high. In the Scandinavian cases, similar tendencies have recently unleashed reform initiatives. The problems are less pronounced in countries with "dual systems" and in the well-functioning school systems in Finland and the Netherlands. The educational north–south divide is largely paralleled in participation in lifelong training and adult education, which by 2008 ranged from 20–30 percent in Switzerland and the Nordic countries to 5–10 percent in Germany and the Southern countries (Cedefop 2013). The first OECD survey of adult skills thus points to huge discrepancies in basic literacy and numeracy proficiency with Finland, the Netherlands, Sweden, and Norway among the top six, and Italy, Spain, and France at the bottom among the 22 surveyed OECD countries (OECD 2013g).

Along with the shift toward tertiary education and the poor development of vocational education, skill mismatch problems strengthened employer demands for flexibility and reinforced government perceptions that less restrictive hiring and firing rules were needed to remedy employment problems—especially in the segments of the labor market that could employ low-skilled workers.

11.1.3 *Changing Labor Market Regulation and Employment Relations*

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

The tendency toward deregulation of temporary work—covering fixed-term contracts and agency work—was especially pronounced in the 1990s (Figure 11.4). The most significant liberalizations occurred in Italy, Germany, and Sweden, but the Netherlands, Spain, and Denmark (regarding agency work), also went along this path. In the liberal UK and Swiss labor markets

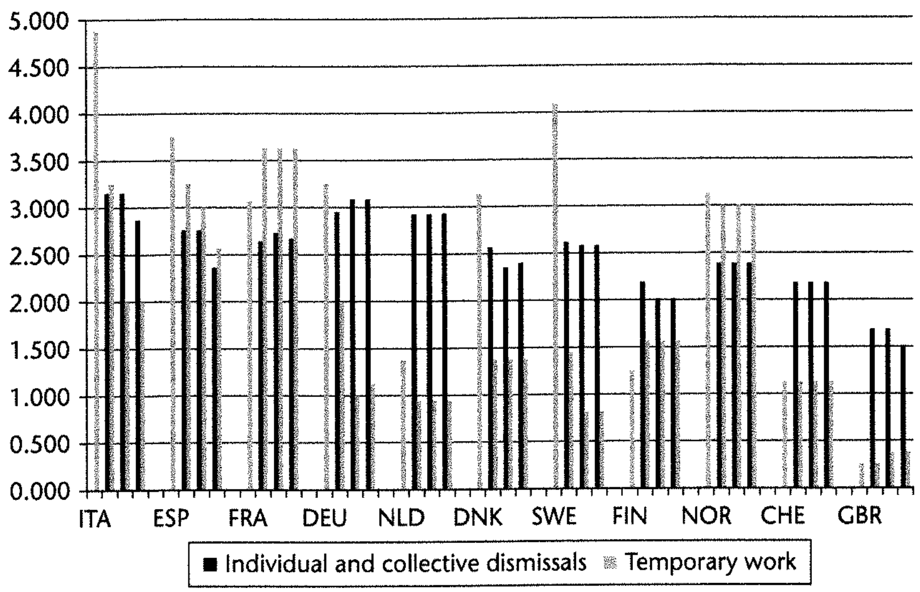

Figure 11.4 Strictness of employment protection regulation regarding dismissals (collective and individual) and temporary work (incl. temporary agency work) 1990, 2000, 2008, and 2013

Source: Revised OECD Employment Protection Indicators, 2013*

* The revised OECD indicators include also rules laid down in collective agreements and court practice. As the revised dismissal indicator is only available from 1998, the first observation here refers to 2000 (<www.oecd.org/employment/protection>).

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

In the EU this tendency was especially pronounced in the Euro-countries forced out of the bond market and subjected to the Troika conditions for financial support (Clauwaert and Schönemann 2012; OECD 2013f: 93). Among our case countries, Spain enacted a series of legislative changes which significantly eased individual dismissals; the notice period was halved,

compensation for unfair dismissals was reduced, and procedures for collective redundancies were simplified by establishing "objective" economic criteria, reducing severance pay, and easing administrative proceedings. Changes in Italy were more modest, mainly restricting possibilities for reinstating unfairly dismissed workers to the more severe cases of discrimination (Chapter 6, this volume). In 2013, the UK, France, and the Netherlands also eased dismissal regulations for permanent employees, alongside some tightening of rules for temporary work.[6] As these changes (except for in the UK) pertained to cases with strong insider protection and quite dualized labor markets, they implied a certain convergence between Continental and Nordic countries, where dismissals for economic reasons have always been quite liberal.

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

In most of the case countries the impact of union decline on collective agreement coverage was limited due to statutory mechanisms for extension of agreements (*erga omnes*), which normally also bolsters the organization rate among employers (Traxler et al. 2001). In the Nordic countries—where only Finland extends agreements on a regular basis—stable organization rates on the employer side maintained coverage. The main exceptions were Germany and the UK, where coverage fell strongly in 1992–2008. During the crisis, there was a major drop in coverage in Spain, while the decline accelerated in

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

Table 11.1 Trade union density, collective bargaining coverage, extension, and minimum wage 1992, 2008, and 2010–2011

	Union density			Bargaining coverage			Extension		Minimum wage	
	1990	2008	2010/11	1992	2008	2010/11		Scope	1992	2008/13
Finland	78	67	69	82	82	89.5*	yes	large	no	no
Sweden	85	68	68.9	89	91	91	no		no	no
Denmark	76	68	68.5	84	85		no		no	no
Norway	58	53	54.6	72	74		yes	small	no	no
UK	38	27	25.8	40	34	31.2	no		no	yes
Germany	34	19	18	70	64	61.1	yes	medium	no	no**
Switzerland	23	18	17.2	48	49	49.1	yes	medium	no	no
Netherlands	25	19	19	82	85	84.3	yes	medium	yes	yes
France	10	8	7.9	92	92		yes	large	yes	yes
Italy	39	33	35.2	83	85	85	no		no	no
Spain	17	15	15.6	82	80	73.2	yes	large	yes	yes

* Finland 2009, ** Germany will introduce minimum wage by 2015
Source: AIAS, ICTWSS database 2013

Germany and the UK. The other countries registered little change. Already prior to the crisis, however, the increased hiring of labor migrants and workers from the new member states posted by foreign subcontractors was often associated with inferior conditions and circumvention of agreements (Dølvik and Visser 2009).[7] In response, many countries changed their laws so as to enable extension in more sectors—among them the Netherlands, Switzerland, France, and, earlier, Norway—eventually followed by Germany which also decided to establish a statutory minimum wage by 2015 (Dølvik et al. 2014). Yet, the efforts to curb wage dumping from foreign subcontractors were constrained in 2007–08 by landmark decisions of the European Court of Justice—the so-called "Laval Quartet" (see Section 8.1.3)—which not only prohibited host country requirements beyond minimum pay set by statute, or extension, and a nucleus of labor standards, but also outlawed union action aimed at securing for posted workers terms beyond those legal minima (Evju and Novitz 2014).[8] By widening the scope for cross-border low-wage competition, this added to the pressures on employment relations and working conditions in the wake of the Euro-crisis.

[7] As a result of increased use of low-paid migrant labor after the fall of the Berlin Wall, the EU adopted in 1996 a directive that should secure workers posted by foreign companies equal treatment with host country workers as regards core labor standards, including minimum wages defined in law or extended agreements (EC 96/71). Except Sweden and Denmark (see Section 8.1.3), most countries relied on varying extension mechanisms, whereas in 1997 the UK established a (low) national minimum wage.

[8] The prohibition of such union action was in 2013 deemed in breach of ILO convention 87 by the ILO Committee on Freedom of Association and also declared in contravention of the European Charter of Human Rights (see Section 8.1.3).

Although the dominant levels of *national collective bargaining* remained fairly stable prior to the crisis—varying between industrial bargaining and peak-level concertation—there was significant decentralization of the actual determination of wages and working time to the company level in most countries. In many instances these processes took the form of organized decentralization—typically in the Netherlands, Sweden, and Denmark,[9] and in sectors with strong bargaining partners, typically manufacturing—but more disorganized patterns of decentralization were spreading, not least in the private services sectors (Traxler et al. 2008). A trend-setting example was in German manufacturing, where company-driven introduction of "opening" or "hardship" clauses in central agreements—alongside increased outsourcing—unleashed a wave of concession-bargaining and hollowing out of the agreements at the company level. During the Euro-crisis such "opening clauses" became standard ware in the Troika tool-kit of "structural reform" (Schulten and Müller 2013).

Paralleling decentralization, the 1990s brought a wave of social pacts and other forms of peak-level concertation (Hassel 2006; Dølvik 2004). In many instances, the revival of tripartite exchange was linked with efforts to develop more articulated forms of multilevel bargaining (Marginson and Sisson 2004) and compensate for institutional weaknesses in countries lacking the traditional prerequisites associated with neo-corporatism, typically Spain and Italy (Regini 1997). As in the Netherlands, Finland, and Norway as well, social pacts were commonly triggered by critical junctures—economic crisis or efforts to fulfill the EMU entrance criteria—and were aimed to promote wage moderation by improving the social actors' coordination capacity and strengthening their co-responsibility for reforms in labor market and social policies, thereby also bolstering state capacity. In contrast to the other countries in the study, none of the large countries—Germany, France, and the UK—were able to develop tripartite exchange. During the Euro-crisis, concertation was revived in Italy, but was largely replaced by unilateral government intervention in Spain, whereas other instances of tripartite exchange, such as in the Netherlands, Finland, and Germany, were mainly limited to specific issues.

The move toward low-inflation policies and monetary integration in the 1990s generated strong pressures for wage coordination and moderation. During the EMU convergence programs of 1993–98, nominal wage increases fell from 7.5 to 1.5 percent in the Euro-area (Janssen and Mermet 2003: 673). With no monetary policy tools left at the national level, and fiscal policy constrained by the EMU public deficit and debt criteria, it was clear that the evolving EMU regime would require increased aggregate wage flexibility at

[9] In Denmark and Sweden this formed part of a broader shift towards sector-based pattern-bargaining.

national levels (Traxler 1996; Pochet 1999). While the ECB and European employers' associations called for more decentralized wage setting adjusted to company variations in productivity, most governments and trade unions tried to bolster competitiveness by strengthening national coordination. Fearing that EMU would unleash a deflationary dynamic of downward wage competition and "beggar thy neighbor" policies (Dølvik 1998, 2004), the European Trade Union Confederation (ETUC) called for a fiscal counterpart to the ECB and for EU-level coordination of macroeconomic policies and wage policies to ensure sufficient demand (Foden 1996; Janssen and Mermet 2003). While it soon became clear that the macroeconomic dialogue between the ECB, the Commission, and the social partners established in 1999 was a purely symbolic exercise, the unions tried to coordinate wage setting on the basis of the "inflation plus productivity growth" formula developed by the European Metalworkers' Federation (Schulten 2001). However, the supposed pace-setting unions in Germany proved unable to fill their role, as reflected in the fall in German real wages and unit costs from the mid-1990s. As this restrained wage setting in surrounding countries (Traxler and Brandl 2009), it contributed to the decline in the labor share of value added in the Eurozone core countries, adding to the effects on labor demand of the restrictive macroeconomic policies imposed by the ECB and EMU rules (OECD 2012c; Glyn 2006: 190–92).

In several countries in the Eurozone periphery, however, the gaps in EMU's economic governance structure (Chapter 2) resulted in credit-driven economic overheating which spilled over to wage setting in the 2000s. In Italy and Spain, however, annual real wage growth 2000–07 was actually lower than in Germany and EU-15, suggesting that the rise in aggregate unit labor costs in Spain had to do with the strong expansion of low-productivity jobs in the non-tradable sectors.[10] Nonetheless, when the sovereign debt crisis brought the core-periphery current account imbalances to the fore, the ensuing policy responses also generated stark divergence in the development of national labor market institutions. In the countries drawn into the sovereign debt crisis, the actors and institutions faced tremendous strains, while the initial effects in the countries that escaped the storm were much less consequential (Marginson 2014).

In the latter countries, the actors mainly responded by invoking traditional institutional tools, alongside a range of incremental and sometimes innovative adjustments undertaken to cope with the initial shocks. Although peak-level crisis-settlements were rare and retrenchment in pensions and social services often sparked union protest and demonstrations, there was some revival of tripartite concertation. Wage moderation was mostly agreed through normal bargaining procedures, often accompanied by clauses allowing exemption from central increments in hard-hit companies. Locally negotiated "emergency pacts" flourished in manufacturing and construction in many countries (Zagelmeyer 2011; Lehndorff 2011; OECD 2010a: 19), often associated with burden-sharing through increased working-hours flexibility and rotating layoffs agreed in local negotiations required to utilize state-subsidized schemes for short-time work (STW) (Glassner et al. 2011). In Germany, the government and the social partners agreed on improved terms and extended application of such STW schemes, and amendments in the same vein were made in other countries. In the Netherlands, central deals were struck on wage moderation, but also on adjustments in unemployment benefits and dismissal protection. In proto-corporatist Finland, the employers called for decentralization of bargaining, but eventually had to go along with tripartite incomes policy agreements. In France, the social partners made deals with the state regarding flexible youth contracts and labor code changes that allowed agreements on reduced working hours and pay in exchange for job guarantees, whereas unions were divided about successive adjustments in pension systems.

In Sweden, the lack of a public STW scheme prompted negotiation of a "crisis agreement" in manufacturing in 2009, where IF Metall acceded to key workplace unit demands to allow local agreements on cuts in working time and pay of up to 20 percent to retain labor and share the burden of job and pay losses in the workforce (Svalund et al. 2013). In the Swedish context such a deal was path-breaking, and was in 2012 followed up by a broader agreement prodding the government to create a state-funded STW scheme from 2014. The unions also got the center-right government to reverse the controversial differentiation of contributions to unemployment funds which had prompted huge membership losses in the funds and the unions alike. In Denmark, however, the Red–Green government's call for a tripartite "crisis settlement" on longer working hours in 2012 was resolutely rejected by the manufacturing unions.

In the countries hit by the sovereign debt crisis, by contrast, the Troika required sweeping changes in collective bargaining institutions, emphasizing decentralization; introduction of "opening clauses" at the company level; de-indexation; more flexible, productivity-based wage setting; and cuts in minimum wages and public sector pay (Degryse et al. 2013). In the ECB and the evolving EU economic governance machinery, the institutions of wage setting became central targets in the agenda for "structural reform," featuring high in many country-specific recommendations adopted by the Council (Schulten and Müller 2013). In Spain, concertation largely broke down, and

[10] Annual real wage growth 2000–07 was 0.1 percent in Spain, 0.8 percent in Italy, 0.9 percent in Germany, and 1.1 percent in EU-15. Labor compensation shares of GDP remained stable in Spain and fell in Italy (Chapter 6, this volume).

the government enacted legislative changes allowing firms to unilaterally change pay and working conditions whenever there are objective economic, technical, production, or organizational reasons (Meardi 2012; OECD 2013f: 12). Firms are also allowed to strike agreements with workers—local unions or even unorganized workers—on terms below those set in sector bargains. Shortening of the termination time for agreements that are not re-negotiated within one year has also eased employer exit from bargaining. Without mooring in a collective agreement, and with low density and patchy industrial relations, the regulative changes in Spain are thus likely to have much greater impact than in Italy, where the conditions for derogations from sector agreements were determined through bi- and tripartite concertation (Chapter 6). A controversial tripartite deal in 2009 signed by only two of the three Italian union confederations was in October 2011 superseded by a bipartite agreement between Confindustria and all three union confederations, allowing local derogations and committing to plant-level bargaining in *future* agreements, ruling out their use in lowering standards. This pre-empted a former decree by the Berlusconi government, allowing local derogations both from labor law and agreements.[11] The Italian unions' consent to bargaining reform could also be seen as *quid pro quo* for a sequence of tri- and bipartite deals transforming the Cassa Integrazione Guadagni (CIG) into a "social shock absorber" (short-term work-scheme), which were eventually complemented by negotiated reform of the unemployment benefit system, reducing the number of uncovered workers from 2 million to approximately 600,000 (Sacchi 2013b).

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

[11] FIAT, which had tried to obtain a deal with the unions along the lines of the Berlusconi Decree, subsequently left Confindustria to pursue its own plant-level goals.

Such dynamics have clearly been amplified by the political pressures from EU/EMU-institutions to undertake "structural reforms" in the bargaining systems (Schulten and Müller 2013). In line with the EU/ECB diagnosis of the malaise as primarily a debt and competitiveness crisis, a widely quoted "main conclusion" of an ECB report on "Euro area labour markets and the crisis" was that "downward wage rigidities are an impediment to restoring competitiveness (and thus employment), particularly in those Euro-area countries that had accumulated external imbalances before the crisis" (Schulten and Müller 2013; ECB 2012: 9). Similarly, a Commission DG ECFIN report suggesting a range of "employment friendly reforms" comprised a sub-section on "wage bargaining framework" that pointed to decreases in statutory and contractual minimum wages, bargaining coverage, and extension of collective agreements, which alongside other measures would "result in an overall reduction in the wage setting power of trade unions" (Erne 2012; European Commission 2012: 103–04). A range of member states have thus received recommendations to adjust wage setting systems, such as calls for decentralization (Italy), or more moderate increases of wages in general (Italy, Finland) or of minimum wages (France), while Sweden was urged to address high wages at the lower end of the wage scale.[12] However, wage increases more in line with productivity were suggested in the case of Germany, which might be viewed as a plea for somewhat higher wage growth. The most direct impact of what Schulten and Müller (2013) have coined as the "new European interventionism" in national wage setting was seen in the countries under economic surveillance by the Troika, where the measures referred to above were often coupled with unilaterally enacted pay cuts and freezes in the public sector, contributing to a decline of more than 6 percent in real wages in Spain and 3 percent in Italy 2010–12.

While these developments have been interpreted as a "paradigm shift" in the EU approach to national wage setting (Schulten and Müller 2013)—hollowing out coordination and multi-employer bargaining (Marginson 2014)—Visser (2013: 2) notes in a report to the Commission DG ECFIN that this is precisely the same approach as the OECD recommended in its 1994 Jobs Strategy, but later had to revise in its evaluation of the strategy (OECD 2006a) as it turned out that "under conditions of efficient coordination inclusive bargaining models [. . .] can perform as good as the exclusive, decentralized systems it had initially recommended" (Visser 2013: 2). Noting also that the EU's new economic governance system favors company bargaining and limiting coverage and multi-employer bargaining, he further states that "[t]his is the exact opposite of the lesson of the 1930s and it is remarkable to a

[12] De facto implying a demand for extension of the low wage sector, this prompted protest from the Swedish unions and the point was erased in the final Council version.

social scientist how such recommendations can be made on the basis of what appears to be very limited econometric evidence and generally poor understanding and measurement of institutions" (Visser 2013: 2).

11.2 Changing Political Dynamics and Economic Frameworks of Social Model Change

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

The ability to form political coalitions capable of conducting change varies partly with political institutions. In countries with proportional representation electoral systems, prior to the crisis the occurrence of viable change coalitions seemed contingent on the presence of either a predominant christian-democratic or social-democratic "catch-all" party able to coalesce to the right or left respectively (Chapter 9, this volume), and to get unions on board where their support was necessary. This was the case in the Netherlands and the Nordic countries in the 1990s, but proved more demanding during the recent debt crisis in the Netherlands and Denmark. Even where such catch-all parties exist, however, bicameralism built on federalism can result in "joint-decision traps" that block change (Scharpf 1988, 1994), as it did in Germany where it took a de facto Grand Coalition between internally divided catch-all parties to break a prolonged stalemate in the early 2000s and implement the contested overhaul of the German social model (the so-called Hartz reforms). Formation of a new Grand Coalition in fall 2013 resolved a long-standing deadlock over establishment of a statutory minimum wage.

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

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

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

Germany's reunification was the most far-reaching of such national precipitants of social model change among our cases (Chapter 3). There, unsurprisingly, the widely supported initial responses to problems resulting from reunification relied on the institutions and instruments at hand in the existing West German social model. While rapid extension of the West German currency at a 1:1 rate, wage rates, and social model institutions generally to the ex-GDR hastened the eastern labor market's collapse, the tools available in the Bismarckian welfare state were used to cope with its social consequences. But the fiscal costs of doing so could not be managed in the context of low growth maintained by the Bundesbank's highly restrictive monetary policy in response to the initial post-unification boom and the taboo on expansionary demand-side policy.

Meanwhile, large firm managers responded to competitive pressures and opportunities, produced in part by the opening to the east, by using the mechanisms of Germany's employment relations system to bring about substantial changes in the labor market. Through local concession-bargaining with works councils and "opening clauses" in sectoral agreements, the hallmark institutions of coordinated wage setting were hollowed out, facilitating a sweeping restructuring which preserved the job security of the core skilled labor force while shifting functions to a growing segment of less protected, subcontracted labor (Streeck 2009). A novelty in company employment relations that eventually became important under the financial crisis was the creation of time accounts that enable greater working time flexibility (Lehndorff et al. 2009). The associated shift of power resources in favor of managers in the labor market and toward the more business-oriented factions in the SPD paved the way for ending the stalemate over coping with the accumulated fiscal squeeze and the violation of the EU Stability and Growth Pact budget rules (that Germany had insisted on), intensified by renewed recession. Absent demand-side options and burdened by the highest real interest rates in the Eurozone—determined by low inflation and the one-size-fits-all rate of the ECB—the German policy-makers saw no other option than resorting to supply-side strategies. With CDU–CSU support in the upper house, the SPD–Greens coalition did so by largely supplanting the Bismarckian system of unemployment and pension benefits, expanding the non-standard, low-wage labor market, and reducing taxes on company profits and capital incomes (Chapter 3 and Scharpf 2012: 117–20). After a period of a CDU–SPD Grand Coalition led by Merkel presiding over the recovery prior to the crisis, the CDU governed in coalition with FDP during the first five years of the Euro-crisis. In the initial phase of the crisis Merkel revived past traditions of social partnership to revamp the Kurzarbeit schemes. Eventually supported by strong economic performance, she also backtracked on the previous agenda of social policy change and actually expanded public expenditure. Still, bargaining coverage and unionism continued to decline. When a new Grand Coalition led by Merkel was formed in fall 2013, besides further change in the pension system, it was also agreed to establish a statutory minimum hourly wage of €8.30, as of 2015, which in accordance with union demands was a condition for SPD entering a new Grand Coalition with the CDU.

In *Italy*, the first critical juncture originated with the breakdown of the postwar party system in the early 1990s that brought the technocratic Dini government into office at the same time as meeting the Maastricht convergence criteria so as to qualify for EMU was perceived as an imperative (Chapter 6). Alongside a substantial initial depreciation of the lira amid the ERM crisis, this combination of factors induced the otherwise divided social partners to strike a compromise to end wage indexation (*scala mobile*) and negotiate reforms in the antiquated pension system favoring unionized insiders. Political division and instability soon brought the reform process to a halt, however, and the spell of coordinated reform efforts among the social partners dissipated once the hurdle of EMU membership had been overcome and a divided center-left was replaced by a center-right coalition headed by the notorious Berlusconi. Hence, in the decade preceding the financial crisis very little was accomplished in terms of overcoming the dualization of the Italian labor market, the gap between North and South, the financial burden of the insider-oriented welfare system, and the huge public debt which to a large extent was held by Italian citizens. When the contagion in the financial markets pulled Italy into the sovereign debt crisis and the country became subject to the EU/ECB regime of crisis management, the political conditions fundamentally changed. Eventually Berlusconi had to resign after heavy pressure from the EU; the technocratic Monti government came into office and adopted a range of saving packages, raised the retirement age, and launched social reforms required by the EU/ECB, despite falling GDP and surging unemployment. However, the still-strong social partners invoked past practices of bilateral and trilateral crisis cooperation aimed to influence the process of change, leading (amongst others) to broadened schemes for short-term work (Cassa Integrazione, CIG), negotiated terms for decentralized bargaining, and extension of the patchy Italian system of unemployment compensation (Chapter 6). When a broad coalition government took over after the 2013 election, Italy seemed to have entered a calmer phase, as in the mid-1990s, but the sluggish economy, high debt and unemployment, and the tightened conditions of the renewed EMU governance system indicated further uphill struggles and political volatility, as illustrated by a new shift of government in 2014.

In *Spain*, EU membership and adjustment to the single market under the Gonzales Socialist government spurred an early wave of government–union pacts aimed at modernizing the welfare state (Chapter 6). But this wave subsided as tensions between Gonzales and the unions built in the context of rising unemployment after Spain tightened monetary policy in order to stay in the ERM during its early 1990s crisis. Under the Aznar Conservative government there was a second wave of pacts—mainly aimed at reforming the collective bargaining and employment protection systems in the dualized Spanish labor market in the course of adjustment to EMU. After the peseta was locked to the Euro in 1999 (at terms implying an effective depreciation of the exchange rate), increased inflation and low real interest rates gave impetus to strong growth in GDP, employment, and public revenues in Spain in the 2000s. The boom was further fueled by surging credit-driven investments in the construction and tourist sectors and by labor immigration. While the 15 years of solid growth enabled the shifting minority governments to modernize the systems of welfare and education and maintain healthy public finances, their limited powers—reliant on support from regional parties—and the fragmented employer side in particular, meant that not much was achieved to overcome the mounting structural problems of the dualized Spanish labor market and economy.

As the Spanish construction boom came to a halt and unemployment started rising in 2007, the Spanish banking system was already in difficulties when the financial crisis hit in 2008. With initially solid budget surpluses and low state debt, the Socialist government of Zapatero tried to halt the downturn with expansionary policies at the same time as it had to rescue failing banks. However, surging unemployment, falling revenues, and fast-growing expenditures resulted in fast-widening gaps in public budgets and rising debt. Although Spain still had a lower public debt ratio than Germany, the herd reactions of the financial markets after the Greek collapse—roughly quadrupling interest on Spanish bonds—pushed Spain into the center of the financial storm in 2010. Under pressure from the EU/ECB, the Zapatero government launched a series of saving packages, raised the retirement age, and invited the social partners to talks on labor market reforms, but in the context of mounting popular protest, youth indignation movements, and several general strikes, such talks soon dissipated. As the storm intensified and the EU/ECB demanded ever more forceful measures of austerity and "structural reform," the Rajoy Conservative government elected in fall 2011 responded to the demands by drastically slashing public budgets, welfare, wages, and pensions, along with sweeping measures to deregulate employment protection and collective bargaining. Although ECB President Draghi's 2012 pledge to buy as much debt as required to calm the markets brought down interest on Spanish bonds, the second dip in the Eurozone recession reinforced the contraction of the Spanish economy, and the rise in public debt, unemployment, and emigration of educated young people continued. Compared to Italy, the prospects for stabilization of the political and social situation, and the relations between the social partners, looked grimmer in Spain due to deepened divisions and loud calls for autonomy among the regional governments (Chapter 6).

In *France*, where there was no crisis comparable to those in Italy and Spain, the pressures for social model change were less acute in both phases (Chapter 4). Given the absence of any tradition of social pacts, and the political mobilization capacity of the divided, competing trade unions—in 1995 forcing out the Juppé government after its efforts to reform the pension system—successive governments under different partisan control limited themselves to cautious and incremental adjustments in social policy. These were frequently driven by ad hoc efforts to meet the EU deficit requirements. Since the restrictive monetary policies of the ECB and stagnant German demand kept French growth low, while alternative increases in revenues were blocked by election pledges to bring down taxes, no real attempts were made to address the growth of public debt. During the Euro-crisis, France steered a difficult course between the hard-hit southern countries and the better-faring northern countries. With strained public finances and rising unemployment, the Conservative Sarkozy government was replaced in 2012 by the Left government headed by Hollande.

However, squeezed between the sluggish economy and EU/ECB demands for austerity, Hollande's calls for more growth-friendly EU policies came to naught and both governments went ahead with contested, incremental changes in the pension system and eventually employment protection—as usual in France, sparking union protest. Yet, the French governments refused to heed the EU/ECB calls for massive spending cuts and sought to stabilize public finances by increasing taxes. After initially reversing Sarkozy's rise in retirement age, Hollande eventually also gained support for adjustments in the pension system and employment protection from a majority of the main unions and employer confederations. However, the economic arm of the Commission continued to criticize France for not enacting tax reliefs and more "structural reforms," which in its view was the only way to boost a dynamic recovery (Rehn 2013). Early 2014, Hollande responded by launching a "responsibility pact" by which employers were promised substantial tax reliefs if they increased employment.

In the *UK*, the economic policy crisis that forced sterling out of the ERM in 1993 permitted a depreciation that opened the way for steady growth. This enabled the New Labour government that entered office in 1997 to make modest changes in the social model, leaving largely intact the more substantial changes made to it under Thatcher's Conservative government (Chapter 5). Apart from introducing a low statutory minimum wage, its main concern was to improve education and health services and increase transfers to families with children at risk of poverty. Together with steady employment growth, these measures halted the rise in income inequality. However, given the majoritarian parliamentary system and New Labour's targeting of the median voter by pledging to keep taxes low, this eventually implied increased reliance on borrowing in the 2000s. In combination with the government's "light touch" on the financial sector and its neglect of the mortgage boom, the consequence was the asset-driven pumping up of a financial bubble.

Thus, the UK entered the financial crisis with huge private debt and higher state debt than most of the Eurozone countries. As the Treasury tried to rescue the City from collapse and counter the downturn with expansionary fiscal policies, state deficits and debts surged rapidly from 2008, making the New Labour government of Brown easy prey for the opposition headed by Cameron in the 2010 election. Although interest rates on British bonds remained low and the UK, with its own currency and monetary policies, had no difficulties servicing its state debt, the Coalition government initiated a harsh austerity program with deep cuts in social spending, increased tuition in education, and higher direct and indirect taxes (VAT), the regressive effects of which were partly compensated by increased transfers to low-income families with children. Still, the National Health Service and the basic traits of the social model inherited from Thatcher and Blair were not fundamentally challenged.

11.2.2 *The Politics of Social Model Change in the Smaller States*

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

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

Contrary to the notion that macro-corporatism was reliant on predominant social democratic parties and strong trade unions, *the Netherlands* and *Switzerland* represent cases where concerted social change was shaped by coalitions in which center-right parties and employers played leading roles (Chapter 7). A case in point in Switzerland was the broadened extension of collective agreements in the 2000s, which was a union precondition for supporting opening of the labor market to the new EU Member States.[13] In the

[13] In a new referendum in February 2014, a narrow majority supported a constitutional amendment which will render EU rules for free movement of labor unconstitutional in Switzerland.

Netherlands the "polder model" was embraced by all mainstream parties (De Beus 2004), but in the early 2000s the central bank and the shifting coalition governments—under growing influence from liberal and welfare-chauvinist parties—were unable to check the rise in asset-based borrowing, pumping up a private debt bubble. Outside the EU, Switzerland saw no such bubble and fared better than most other countries during the Euro-crisis, partly because the surge in labor immigration from the enlarged EU boosted domestic demand.

The Netherlands also seemed to ride out the financial crisis smoothly, but from 2012 the combination of private deleveraging and austerity policies brought decreasing demand and employment, pushing state deficits and debt above EU/ECB thresholds. Conflicts over further austerity packages led to dissolution of the center-right coalition in 2012, as the populist party (PVV) withdrew its support, but the incoming coalition of liberals and social democrats "even intensified the austerity drive, mainly to avoid the wrath of international financial markets and the disciplining measures from the European Commission" (Chapter 7). Consequently, populist Euro-skeptical parties on the right and left were surging in the polls. In spite of growing union unease, the Dutch concertation continued during the crisis. In 2010, the unions consented to a rise in the retirement age from 65 to 66 in 2020, pegging further changes to life expectancy, and, after long-term employer pressure, the unions were in 2013 forced to sign a pact reducing unemployment benefits to one year and overhauling employment protection for open-ended contracts.

In the *Nordic countries*, severe self-inflicted crises in the early 1990s prompted negotiated adjustments of collective bargaining regimes and social policies, alongside significant changes in macroeconomic governance (Chapter 8). In contrast to most Continental countries, however, Finland, Norway, and Sweden benefited from substantial currency depreciations after their financial crises. Kick-starting export-driven economic recoveries, this enabled Finland and Sweden to reduce their huge budget deficits and unemployment without undermining their welfare states, while Norway benefited from soaring oil revenues. The employers in the Nordic countries also pushed for decentralization of collective bargaining, and fixed-term work was liberalized in Sweden. However, due to strong trade union counterpower, employer division, and active state orchestration, mostly under social-democratic-led governments, the crises eventually led to renewed forms of coordinated wage restraint and stabilization-oriented economic policies, along with pension reforms and strengthened activation policies mostly based on conditionality rather than cuts in benefits.

This trajectory of negotiated consolidation and renewal of the models won broad popular support and proved largely successful—regardless of their different ties to the Euro—leading the center-right parties to give up their opposition and embrace the Nordic models in the 2000s. This eventually brought them back into office in all four countries, where the main policy changes were associated with tax reliefs, benefit retrenchment, and inroads in the union-administered unemployment funds. During the financial crisis, Sweden and Finland were among those hit hardest by the initial collapse in trade, but as trade rebounded fast they did too, as did Norway. Thanks to solid public finances—and also depreciating currencies in Sweden and Norway—all countries could let the automatic stabilizers of their large welfare states work and pursue countercyclical policies, curbing the rise in unemployment. In Denmark, however, the lack of monetary policy tools due to the currency peg to the Euro, alongside previous credit liberalization and pro-cyclical fiscal policies, had created an asset-driven private-debt bubble, as in the Netherlands and the UK. The collapse of the bubble brought prolonged recession, severe employment decline, and retrenchment of unemployment and other benefits in the wake of the financial crisis. In Finland, the collapse of the Nokia cluster and the global pulp and paper industries, together with tighter fiscal policies in accordance with EU recommendations, produced a renewed recession from 2012 and unemployment was still rising by Spring 2014. In spite of strains, especially in Sweden and Denmark, tripartite cooperation was largely maintained during the crisis. In Sweden, where unemployment has stabilized around 8 percent, the unions in agreement with employers eventually succeeded in pressing the center-right government to establish a public scheme for short-time work. Faced with an upcoming election and bad polls, the government also gave in to union demands for reversal of its contested earlier differentiation of fees in the unemployment funds. The center-right coalition in Sweden and the social-democratic-led coalition in Norway were re-elected in the midst of the crisis in 2009, while the center-right coalitions in Denmark and Finland were replaced by a Red–Green coalition in Denmark and a Grand Coalition in Finland in 2011. A common feature in all four countries, however, was the rise of welfare-chauvinist, Euro-skeptical parties, posing new challenges for the dominant "catch-all" parties to both the left and the right. In Norway, this brought the populist Progressive Party into office for the first time, in coalition with the Conservative Party in 2013.

11.2.3 *Diminishing Scope for Party Politics*

It has been argued that the course of social model change in recent decades has been independent of the partisan composition of governments (Palier 2010b). The above review of the case studies offers some apparent support for this view. A common explanation is that due to institutional "path dependencies" (Pierson 2001) and mechanisms of "blame avoidance" and "credit claiming" (Bonoli and Natali 2012), most governments, except in extraordinary

circumstances, rely on incremental change through mixes of layering, drift, stealth, conversion, and trial-and-error sequences (Streeck and Thelen 2005). Another common explanation is the impact of policy ideas and discourses propelled by international agencies such as the OECD and EU (Hemerijck 2013), the importance of which evidently took a radical new turn in the Eurozone countries during the recent crisis.

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

EU members outside EMU—the UK and most Nordic countries—could, after their crises in the early 1990s, rely on monetary instruments, i.e., the interest rate and exchange rate adjustments—to redress macroeconomic imbalances, boost growth, and consolidate budgets, therefore coming under less direct pressure to shake up their social models.[14] Allowing the actors to focus on labor market problems that arguably could stem from deficiencies of the welfare and labor regimes, healthy growth also made it easier to gain acceptance and support for social model reforms at the same time as growth magnified the effects of reform by greasing the wheels of labor market adjustment. By contrast, countries involved in the EMU convergence process leading to introduction of the Euro had less leeway for coping with the macroeconomic parts of their problems and were to a greater extent compelled to rely on various forms of "internal devaluations" to overcome them. As pointed out by Scharpf (2012) in the German case, absent demand-side options, the only tools left for rebalancing the economy were supply-side measures which in practice would involve cuts in the welfare state and liberalization of the labor market. In contrast to Germany, politicians in Italy and France shied away from such measures for electoral reasons and chose to rely on a mix of tax reliefs and state borrowing, which were the only remaining demand-side instruments in their macroeconomic tool-kits that could stimulate growth in the short-run. The flip-side was that such strategies magnified the longer-term growth in state debt, further constraining the scope for political choice when

[14] Also in Italy, depreciation after the ERM crisis spurred recovery and eased the transition into EMU.

the Euro-crisis eventually hit, given the Eurozone's economic governance structure. Conversely, with no monetary instruments left and foreign credits flowing in, the governments and fragmented social partners in Spain were unable to use fiscal or wage policy tools to cool down the overheating economy before the bubble burst.

Thus, the structural narrowing of the available policy instruments within EMU implied that political actors on all sides had to choose from the same restricted menu of policies, arguably making the differences in political priorities among them harder to detect. Besides leading to more frequent ousting of incumbent coalitions, this was accompanied in several countries by a rise of welfare-chauvinist protest parties. Although EMU constraints seemed to foster more social policy convergence inside than outside the Eurozone, the country case studies do suggest that political priorities and means differed between coalitions with different composition, constituencies, and support from—and power relations among—the social partners. Similarly, Iversen and Soskice (Chapter 9, this volume) show that in cases with systems of proportional representation, government responsiveness to inequality-increasing economic shocks differed substantially between Nordic countries with a tradition of center-left coalitions and Continental countries with a tradition of coalitions led by Christian democrats. Typically, the electoral successes of center-right coalitions in the 2000s habitually also implied more emphasis on tax reliefs and benefit retrenchment—often combined with credit liberalization—and in the Nordic countries also initiatives to weaken union power. Besides weakened automatic stabilizers and reduced leeway to cushion the effects when the financial crisis hit, such political swings often contributed to asset bubbles that aggravated the crisis, as illustrated in Denmark and the Netherlands. Hence, the depth of the crisis and the options available to cushion it were frequently influenced by political choices and shifts in coalition-building made prior to it; contrary to the common blame on too generous welfare states, in many cases budgetary problems seemed to stem from weak ability and political will to collect enough tax revenues to fund public services (Figure 11.2).

Another lesson from the case studies is that the effectiveness of "internal devaluation" strategies clearly varies between smaller and larger countries (Fitoussi and Laurent, 2009). In Europe's largest economy, Germany, the prolonged period of wage restraint aimed to boost export had such strong contractive effects on domestic demand that the mounting problems in the labor market and public finances in the early 2000s forced the Red–Green government to enact even harsher measures. The export-based German strategy also forced France to adopt competitive disinflation policies, spurring similar (albeit milder) contractive effects there. By contrast, several of the small states in the Eurozone, such as the Netherlands and Finland, were not

only able to muster broad support for wage restraint and social model change through social pacts in the 1990s,[15] they also reaped larger benefits through swift export-driven growth and budgetary consolidation while experiencing weaker effects on domestic demand, job creation, and inequality than in Germany. In line with the small states outside EMU, such as Denmark, Norway, Sweden, and Switzerland, these countries also benefited from the advantage of closer ties and higher trust among politicians and the social actors, which, in contrast to Germany, were anchored at the peak level and embedded in long-standing institutions for tripartite problem-solving (Thelen 2014; Katzenstein 1985).

However, during the Euro-crisis, when the entire EU turned to austerity and adopted competitiveness-oriented small-state policies, the strong European multiplier effects clearly undermined the effectiveness of such export-oriented strategies. It is also notable that in pace with rising immigration and political skirmishes with the EU regime for coordination of social security and labor market rights, the Euro-skeptical welfare-chauvinist parties gained increased momentum in many of the corporatist small states, conquering influential tipping positions, for example in Denmark, the Netherlands, and Norway. Such dynamics were magnified during the Euro-crisis when the turn to austerity and welfare retrenchment strengthened the resonance of these parties' rhetoric and made them surge in opinion polls in France and the UK as well.

Clearly, while competitive "internal devaluations" can work for small states even in the integrated European economy, they cannot readily be replicated by the larger states or by the EU as a whole without severe social and economic costs. Yet that was precisely what the European politicians decided to do in the midst of the Euro-crisis, binding each other to supranational rules, underpinned by the threat of sanctions, making austerity and "structural reforms" of social models the center-pieces of their strategy to exit the crisis. This implied a qualitative shift in the political conditions for social model change, most conspicuously when the previous issuing of "soft" recommendations was replaced by hard EU/ECB requirements of labor and welfare reform as ultimate conditions for support to debt-ridden Euro-countries. Virtually reducing the governments in these countries to executors of instructions from the Troika laid down in "Memoranda of Understanding," this implied a shift in power toward the executive branch, largely reducing parliamentary politics to rubber-stamping of scripted policies. The consequences have been less intrusive in the countries that avoided the sovereign debt crisis, but there also the new EU regime of economic governance poses tougher constraints on the politics of social model development.

[15] Similar strategies were pursued in Ireland, Austria, and Belgium.

Whereas social policies remained a national prerogative when EMU was launched by Delors alongside the vision of a "Social Europe," EMU member states have now placed themselves in a situation where their social models are at the mercy of constitutionalized, supranational rules that require permanent macroeconomic rigor from all. Through the multiplier effects in the integrated European economy such a regime is likely to restrain growth, employment creation, the funding base for the welfare states, and thus the political conditions for social model development. With prospects of downward convergence in struggling countries and chilling effects on standards in better-off countries, the risk is that the Treaty objective of upward convergence will give way to a scenario of increasing divergence in the political conditions for the development of social models and labor market outcomes, which we turn to next.

11.3 Labor Market Outcomes: Employment and Income Distribution

In this section we compare developments in labor market outcomes prior to and during the Great Recession, and discuss how they were affected by supply-side changes in the social models and shifts in macroeconomic conditions. We first look at the trends in unemployment and employment. Then we review the trends in inequality, their relationship with employment growth, and address the issue of whether there is a trade-off between increasing employment and decreasing inequality.

11.3.1 *Employment and Unemployment*

At the beginning of the 1990s, employment rates in the case countries varied from 50–60 percent in Spain, Italy, and France to 75–80 percent in Switzerland and the Nordic countries (Figure 11.8). Unemployment ranged from 1–3 percent in Finland, Sweden, and Switzerland, and 7–8 percent in Denmark, United Kingdom, France, and Italy to 14 percent in Spain (Figure 11.5). The recession in the wake of German reunification and the ERM crisis produced large job losses in most countries, especially Spain, but also Finland and Sweden, where self-inflicted financial crises drove up unemployment. From then up to the financial crisis in 2008, employment rose and unemployment fell at very different rates in the case countries. In the 1990s, the decline in unemployment was especially strong in Spain, the Netherlands, the Nordic countries, and the UK. In the 2000s, unemployment also fell markedly in Italy, while it remained more persistent in France and continued rising in Germany until the trend turned in 2005. By 2008 German unemployment had only fallen to just below its 1993 trough.

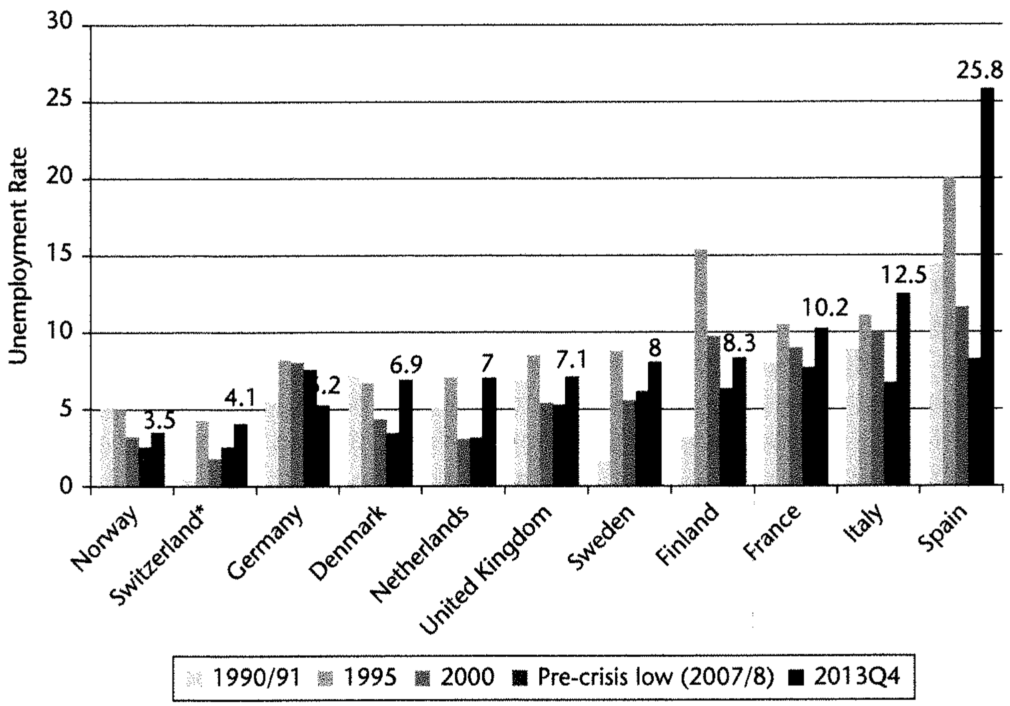

Figure 11.5 Harmonized unemployment rates in European case countries, 1990–2013Q4, ranked by level 2013Q4

*Switzerland, registered unemployment 1990–2008.
Source: OECD.stat

During the crisis beginning in 2008, the reductions in unemployment achieved in the preceding decades were wiped out in Italy, France, and Spain, bringing unemployment to record high levels. From low levels, Denmark and the Netherlands also experienced sharp increases when their asset-driven bubbles burst. With more modest increases in the other countries, and a remarkable decline in Germany, the unemployment rank order of the case countries by 2013 was almost similar to that in 1990. One exception was that unemployment in Sweden and Finland, after their financial crises in the 1990s, had never come down to their former low levels and by 2013 was above the mean of the 11 case countries.

The changes in unemployment were in both periods related to the rate of growth in GDP, though not uniformly. From the early 1990s crisis until 2008, the largest decreases in unemployment came in economies with strong growth and initially high unemployment—i.e., Finland and Spain—while the smallest declines were in those with weakest growth—Germany and Switzerland. Between these outliers, countries with higher growth but initially low or medium unemployment—the Netherlands, Norway, Sweden, and the

UK—naturally saw smaller absolute declines, whereas countries with initially higher unemployment, such as Italy, France, and Denmark, experienced somewhat larger declines even with modest GDP growth.[16] These variations suggest that the pace of unemployment reduction was also influenced by supply-side factors. The propensity to enter or stay in the job-seeker queue varies with both labor market tightness and institutional factors. For instance, although Italy and Germany experienced equally mediocre growth, open unemployment fell much less in Germany, which scrapped its early retirement schemes but maintained generous unemployment benefits (until 2005) than in Italy, where ample early retirement opportunities for insiders and the patchy unemployment benefit system evidently contributed to lower inflows and higher outflows of the stock of unemployed than in Germany.

During the Great Recession, the initial surge in unemployment obviously resulted from the collapse in demand triggered by the financial meltdown, sharply cutting trade in manufactured goods and in many cases halting construction. Thus, the immediate labor market consequences depended heavily on the size of the manufacturing export sector and the presence, or not, of bubbles bursting in the national building and banking sectors. In countries hit mainly by the initial drop in manufacturing trade, especially Sweden and Germany, the labor markets rebounded quite fast in 2010–11 as exports to the "emerging" Asian economies recovered, supported by the countercyclical economic policies. However, in countries where credit-driven bubbles in banking and housing markets burst—Spain, Denmark, the UK, and eventually the Netherlands—unemployment continued to grow as the contractive effects of private deleveraging spread throughout the economies. When the EU then turned to austerity in response to the sovereign debt crisis, the contraction of demand was amplified and spread via trade multipliers to the less affected countries, resulting in the second dip in the Eurozone in 2012–13. Thus, the accumulated rise in unemployment 2008Q2–2013Q4 was obviously a consequence of the contraction of demand generated by the squeeze of credit and private and public spending in many of the countries. The steepest rises in unemployment occurred in the countries with the most severe declines in GDP—typically, Spain and Italy—while the lowest increases (and even declines) occurred in Switzerland, Norway, and Germany—all with swift recoveries after the initial slump.

However, there were substantial variations in the relationship between changes in GDP and unemployment. These variations were especially pronounced in the initial phase of the crisis, when national differences in dismissal rules and short-time work schemes as well as in the most affected sectors

[16] In relative terms unemployment fell more than 50 percent in the Netherlands, Denmark, and Norway, 30–36 percent in France, Sweden, and Italy, and only 10.6 percent Germany.

influenced the propensity to hoard labor and avoid layoffs (OECD 2010a; Boeri and Brücker 2011). The initial rise in unemployment was thus, ceteris paribus, slower in Continental countries with strict dismissal regulations, ample use of publicly subsidized or other short-term work schemes, and no construction bubble—notably Germany—than, for instance, in the UK and the Nordic countries, where collective dismissal rules are less restrictive (Figure 11.4), and Spain, where the share of easily dispensable temporary workers was especially high in the collapsing construction sector. Although the effects of such institutional differences diminished as the recession dragged on, remarkable national differences persisted even after five years. In the cases suffering from the most severe, prolonged recessions, the accumulated 6 percent (year-on-year) drop in GDP in Spain had by 2013 generated an 18 percentage point increase in unemployment, while the larger GDP declines of 9.3 percent in Italy and 7.5 percent in Denmark, by contrast, were associated with much lower unemployment increases (6.2 and 3.3 percentage points, respectively). Similarly, among the best performing, growing economies, unemployment in Sweden was by 2013 still 2.0 percentage points higher than in 2008, contrasted with a drop of 2.3 points in Germany where GDP growth was weaker. Other deviant countries were Finland, where a sharp GDP drop was associated with limited unemployment growth, and the Netherlands, where a comparatively modest decline in GDP was eventually accompanied by the third highest rise in unemployment. The two countries with the strongest rises in unemployment relative to the decline in GDP—Spain and the Netherlands—had the highest shares of temporary jobs prior to the crisis (Figure 11.7). Thus the impact of a given drop in GDP on labor market outcomes was evidently strongly conditioned by supply-side dynamics and institutions.

With respect to employment as well, in both periods there was a clear relationship to GDP growth (Figure 11.6). Not surprisingly, the relationship was clearer during the crisis than in the 15 years preceding it, when longer-term changes in labor supply and institutions evidently exerted considerable influence on job growth. During the pre-crisis period (1994–2008), all four case countries with strong average annual employment growth (>1.5 percent) also had solid GDP growth (> 2.75 percent), while all three countries with low GDP growth (< 2 percent) experienced low job growth (0.5–1 percent). Evidently, substantial employment growth is hard to achieve without sustained growth in demand. Still, among both the countries with high and low GDP growth there was considerable variation in job growth.

This undoubtedly reflects the impact of longer-term changes in labor supply and the distribution between full-time and part-time jobs. With 4.5 percent annual job growth 1994–2008, Spain stood out as an extreme outlier in this period, bearing witness to the interaction effect of strong demand growth and simultaneous shifts in (female) labor supply. A similar "catching up" effect

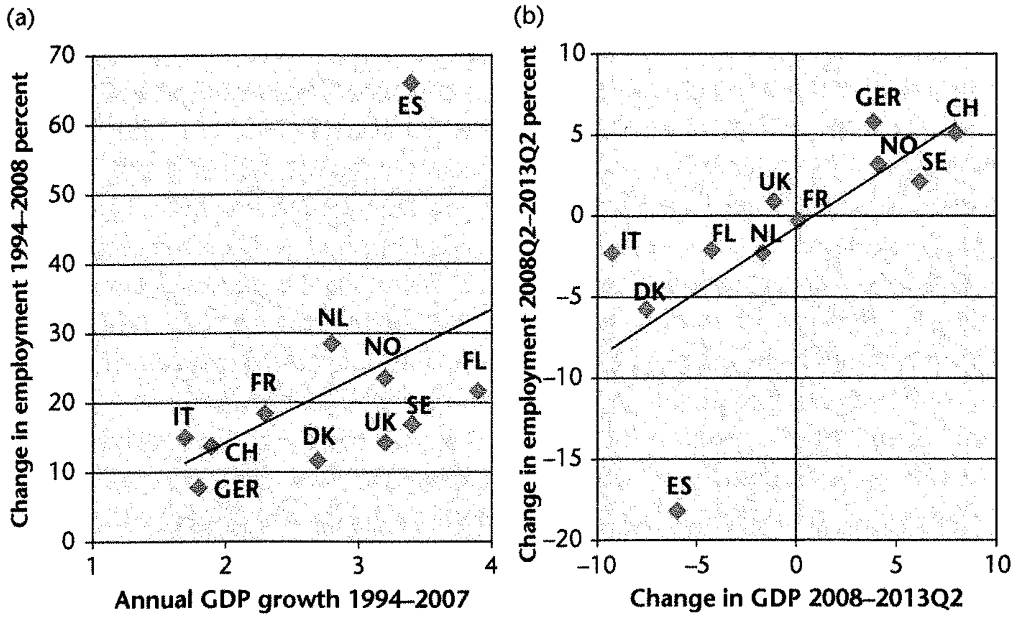

Figure 11.6 (a) Change in employment 1994–2008 and average annual GDP growth 1994–2007, percent; (b) Net change in employment and year-on-year change in GDP 2008Q2–2013Q2, percent
Source: OECD.stat

was seen in the Netherlands, where there was a massive rise in female, part-time work. In spite of comparable GDP growth, job creation was more muted in the UK and the Nordic countries, where female employment was already high in the early 1990s and women increasingly opted for full-time work. In contrast to the Spanish "employment miracle," the outlier at the other end was Germany, where anemic growth was associated with a virtually flat job market—only 7.8 percent job growth in 14 years—and a decline in full-time work until the economy recovered from 2005 onward. Burdened by the highest real interest rate and exchange rate in the EMU, minimal wage growth, and restrictive fiscal policies, the situation in the German labor market was almost a mirror image of the Spanish one, where a low real exchange rate and interest rate together with the credit-driven building and banking boom in the 2000s brought strong growth in labor demand, absorbing a rapid growth in immigrant labor. However, during the subsequent crisis the picture was totally reversed.

During the recent crisis, the relationship between changes in employment and GDP was much stronger than in the former period. In total 10.5 million

jobs were lost in the EU by mid-2013, of which 8.3 million came in the Eurozone. Employment increased in all of the cases with net GDP growth over the five years, while it decreased in all but one case with falling GDP. The exception was the UK, where a modest decrease in GDP gave room for a slight increase in (mostly part-time) employment. Even during the crisis, however, the job effects of GDP changes varied substantially. Again, Spain stood out as an extreme outlier, with three times as large annual drops in employment as in GDP (–3.6/-1.2), followed by the Netherlands, where a modest drop in GDP caused rapid declining employment (–0.46/–0.33). Also in Denmark, known for its lax dismissal protection and high mobility in and out of the labor market (Berglund et al. 2010), employment fell markedly relative to GDP. Strikingly, these three countries were all struggling with the repercussions of exploding private debt and banking bubbles, illustrating the labor market impact of declining private consumption and of the underlying dysfunction of financial markets. In Italy, with the strongest decline in GDP, but no private debt crisis, the ratio was much lower (0.46/1.85). The same pertained to Finland, where manufacturing was the main casualty and strong automatic stabilizers kept up demand until the government was forced to tighten spending from 2012. In France, there was very little overall change in GDP and employment, suggesting that the steady rise in French unemployment was significantly influenced by increasing labor supply.

Among the countries with rising GDP over the crisis, the employment intensity of growth also varied markedly. In contrast to the preceding decades, Germany now exhibited the highest ratio of job growth relative to GDP growth (1.2/0.8), while job growth was weakest in the fast- growing Swedish economy. The strong job growth in Switzerland was enhanced by the highest rate of labor immigration in Europe, which also accounted for more than two-thirds of net job growth in Norway.

CHANGES IN THE COMPOSITION OF JOBS: THE IMPACT OF DEREGULATION AND ECONOMIC DEMAND

Through increased flexibility of hiring and firing, most—but not all—of our cases experienced a rise in atypical jobs prior to the crisis. The general rise in female part-time work was most pronounced in the Netherlands, where the part-time share among working women in 2008 passed 60 percent (OECD. stat). The deviant cases were the Nordic countries and France, with modest and falling part-time shares. During the Great Recession, the share of part-time work increased in all the countries with stagnant employment, while it decreased in Germany, Norway, Sweden, and Switzerland where employment increased. The upward trend in temporary work was also strongest in the

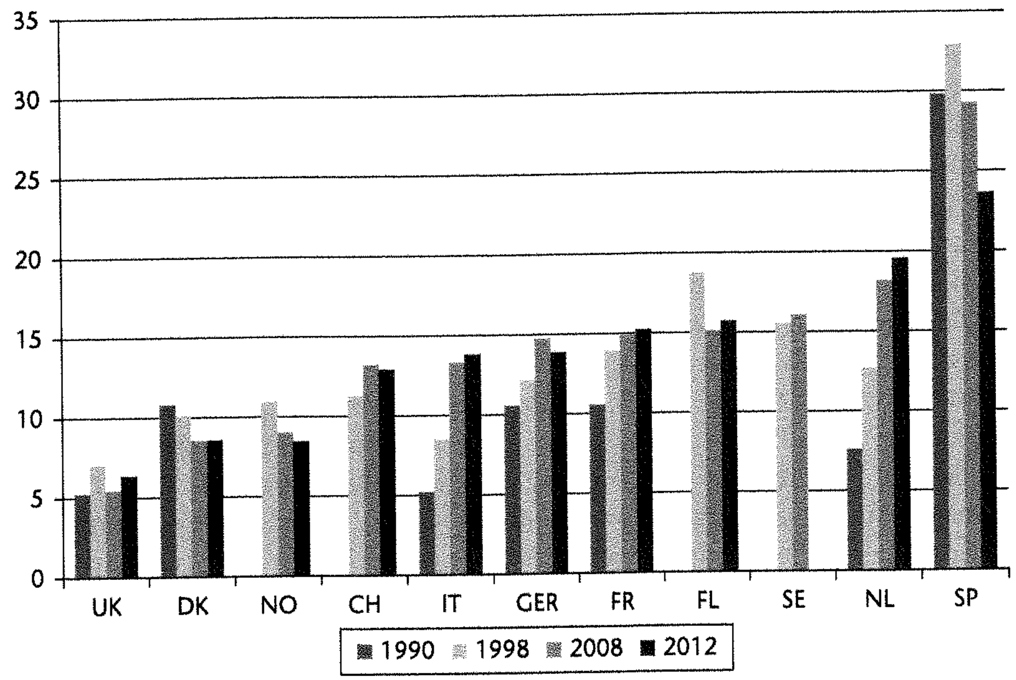

Figure 11.7 Share of fixed-term work in employment, 1990–2012 (percent)
Source: OECD.stat

Netherlands, where temporary work was liberalized in the 1990s without any easing of the strict protection for core workers (Figure 11.7).[17]

The level of fixed-term work is influenced by the relative degree of protection for permanent vs. temporary workers (OECD 2010; 2013f). The levels were thus low in countries with either liberal or strict protection of both categories, notably in the liberal UK and Denmark, and in Norway where regulation was strict for both categories (Figures 11.4 and 11.7). Conversely, in countries with strict protection of permanent jobs and liberal rules for temporary work, which was the direction in which most Continental countries as well as Sweden and Finland moved in the 1990s, fixed-term employment tended to be high. Around these different levels, the rate of change in temporary work was inversely associated with growth. For instance, in Germany and Italy the share of temporarily employed rose sharply after liberalization in the 1990s and accounted for 100 percent of net employment growth 1991–2001, implying that permanent jobs were replaced by temporary jobs. A similar trend was seen in Sweden and Finland after their crises and deregulation in the 1990s. In the faster-growing Netherlands temporary jobs accounted for 40 percent of net job growth, while the share was 50 percent in France, where growth was slow but little regulatory change occurred (Maurin and Postel Vinay 2005: 231; Heyes 2011: 647). By contrast, the strong job growth in Spain brought a substantial drop in the extremely high level of temporary work in the 2000s. There was also a downward or flattening tendency in temporary work in the UK and the Nordic countries, which was also the tendency in many Continental countries during the boom from 2006 to 2008 (European Commission 2011).

[17] The Netherlands also saw a steep rise in agency work after its 1996 "flexicurity" deal—in 2011 accounting for 3 percent of employment (CIETT 2011) compared with around 1.5 percent in most other cases.

During the crisis, those in temporary contracts were usually the first to be dismissed. But when employers slowly started hiring again, the uncertain prospects often led them to initially prefer temporary contracts, eventually turning to more permanent hiring when growth took hold (European Commission 2013c). Hence, the share of temporary contracts increased in the cases with stagnant labor markets, except Denmark and Spain, while it declined somewhat in the countries with expanding labor markets. With strict protection of permanent workers, Spain is a deviant case where the high share of fixed-term work shrunk both during the 2000s boom and during the crisis, while the stock of easily dispensable temporary workers remains extraordinarily high. When labor markets start recovering in the hard-hit countries the uncertain prospects are likely to make temporary hiring predominant in the early phase, even though recent attempts to ease protection for permanent workers (see Section 11.1.3) may weaken the incentives to do so.

When comparing the changes in employment and the shares of temporary work over the entire period (1990–2012), it is hard to find any positive relationship between the two. Of the seven cases with employment rates above 70 percent in 2012 (see Figure 11.8), four countries had low shares of temporary work—Norway, Denmark, the UK, and Switzerland—while the Netherlands, Sweden, and Germany had high shares. Among the three cases with lowest employment rates in 2012—Spain, Italy, and France—all had high shares of temporary work. As earlier mentioned, this also pertained to the cases suffering the largest employment declines during the crisis—i.e., Spain, the Netherlands, and Italy—except Denmark, where dismissal protection is generally liberal. Thus, contrary to the proposition that easier access to temporary work leads to higher employment, it seems from our study that deregulation and rising temporary work tend to occur as a consequence of poor employment performance rather than as a driver of labor market growth. Accordingly, the OECD (2010a, 2013f) has found that the past decades' liberalization of temporary work has not brought more net employment, but has mainly substituted temporary for permanent jobs—as illustrated in Germany up to 2005—thereby contributing to the dualization of the labor market.

Further, the impact of partial deregulation on the structure of employment seems contingent on the trajectory of demand growth: the lower the prospects for sustained growth in labor demand, the higher the share of temporary jobs in job creation and the weaker the bargaining power of the employees competing for stable jobs.

EMPLOYMENT RATES: A FUNCTION OF SOCIAL MODELS?

The target of the European Employment Strategy adopted by the EU in 1997 was that all member states should reach employment rates of a minimum of 70 percent. As the 1990s began, there was a huge gap in employment rates, ranging from 52 percent in Spain to 83 in Sweden, reflecting an even greater gap for women, ranging from 32 percent in Spain to 81 in Sweden (Figure 11.8).

After the post-reunification recession, employment rates grew at very uneven rates in the 1990s. In Finland, Spain, and the Netherlands, rates were rising fast from low levels, especially among women, while the rates in the UK, Switzerland, Denmark, Norway, and Sweden rose further from higher

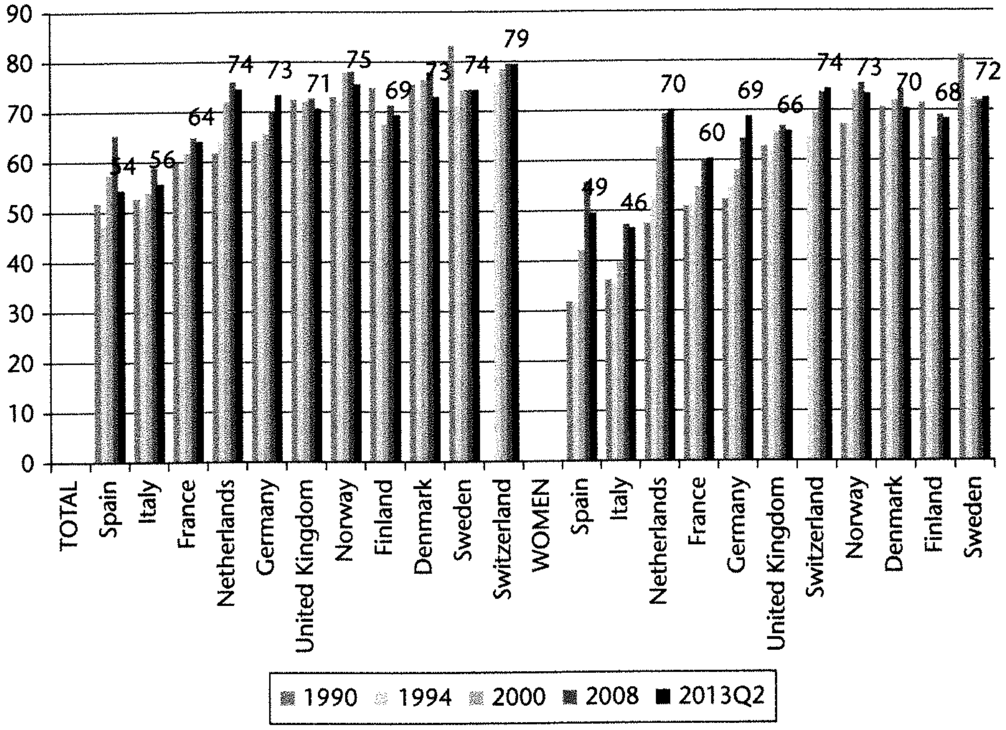

Figure 11.8 Employment rates—all and women (15–64) in European case countries, 1990–2013Q2 (Ranked by level in 1990, figures refer to rates 2013Q2)

Source: OECD.stat

levels. By contrast, the slower growing economies of Italy, France, and especially Germany saw only modest increases from low levels, in spite of rising female employment. After the ICT-bust, the boom in the later 2000s also brought fast rises in France, Italy, and Germany, altogether contributing to a certain narrowing of the north–south employment gap prior to the financial crisis. During the prolonged crisis, however, more than half of the gains achieved in the previous two decades were wiped out in the hardest-hit countries (Spain and Italy), and all of it in Denmark, while the only country with a rising employment rate was Germany.

Prior to the crisis, after 15 years of EU monetary integration and significant social model change, none of the larger countries in the Eurozone had passed the EU minimum target of 70 percent, while all the EMU outsiders and the smaller Euro-countries were well above that target. As the right panel of Figure 11.8 shows, employment rate trends were closely related to differences in the levels and pace of growth in female participation. At the top, Denmark, Norway, and Switzerland had passed Sweden and Finland, which 15 years after their financial crises had still not reached pre-crisis levels. Nonetheless, taking into account the discrepant trends in female part-time work, the employment gap between the Nordic countries and most of the other case countries was almost unchanged in terms of full-time equivalents.[18] Measured in full-time equivalents, the female employment rates varied prior to the crisis from above 60 percent in the Nordic countries, just above 50 percent in France, UK, and Germany, down toward 40 percent in the Netherlands, Spain, and Italy (OECD 2010a).

As shown above, the pace of growth in employment depended on sufficient demand growth, but employment rates are significantly influenced by labor supply changes, especially among women and the elderly, and by changes in the social models facilitating higher labor market participation. Hence, the cases with lowest employment rates in 2008 were also those where the educational level of the working-age population was lowest, whereas those with the highest employment rates were marked by high and rising levels of education, not least among women (see Figure 11.3). Still, in the cluster already with high employment rates in 1990 (the Nordic countries, Switzerland, and the UK), the rise tended to level out in spite of solid growth, indicating that the reservoirs of inactive women and elderly were shrinking and becoming harder to mobilize. Growing immigration may have added to this by increasing both the share of less readily employable citizens—especially among women—and the population denominator. In parallel,

[18] In full-time equivalents the employment gap between men and women varied in 2007 among our cases from 7–13 percent in the Nordic countries to 22.9 percent in Germany and 29.1 percent in the Netherlands (Hemerijck and Eichhorst 2010: 312).

there was a catching-up tendency among the Continental and Southern countries, reflecting the secular trend toward higher participation among women and the elderly. It is striking, however, that such efforts evidently bore much less fruit in countries with low GDP growth, notably the Euro-core countries of Italy, France, and Germany, than in the stronger-growing Spain, Finland, and the Netherlands, where skill levels were also rising markedly faster than in the former. The interaction between growth in demand and labor supply is further underscored by the German development, where employment rates remained almost unaltered until growth took off during the boom from 2005, suggesting that attempts to boost employment by social model reform are ineffective if they are not supported by sufficient economic growth and labor demand. While this relationship was contested prior to the crisis—when employment problems in the EU were largely attributed to supply-side deficiencies—it was made abundantly clear when demand collapsed during the financial crisis and its aftershocks.

As the working-age population does not change much in five years, the swings in employment described above (Figure 11.6) were mirrored in the changes in employment rates during the recent crisis (Figure 11.8). However, female employment rates changed much less than among men. In the hardest-hit case countries, female rates fell only 0.8 points in Italy, vs. 6.1 among men; 6.3 points in Spain, vs. 15.5 among men; and 3.9 points in Denmark, vs. 7.7 among men. Furthermore, there were only modest changes among women in the other countries, except Germany, where the female employment rate rose strongly, by 4.3 percentage points. Apart from Germany, all the case countries thus experienced falling employment rates among males, reflecting the high share of men working in cyclically sensitive industries.

Contrary to expectations, however, there was no decrease in participation rates, which in fact increased somewhat in most countries during the crisis. The exceptions were Denmark, Norway, and Finland, where falling participation among youth curbed the rise in unemployment. It has been suggested that the divergent trends in male and female employment rates during the crisis reflect increased labor supply among women in households where the spouse became unemployed, but almost comparable rises were seen among single women, suggesting that this is only part of the explanation (European Commission 2013b).

SOCIAL MODELS AND THE LABOR MARKET EFFECTS OF THE CRISIS

The observations in this section lend limited support to the view that the economic and labor market consequences of the crisis were a function of the extent to which the countries had reformed their social models prior to it. Typically, countries which in the preceding decade were hailed for their "flexicurity" models and active labor market policies (Denmark and the Netherlands) were among the cases with highest losses of jobs relative to the drop in GDP. Among the cases hit by sovereign debt crisis, Spain was greeted for its modernization of the welfare state, social pacts, and solid public finances in the preceding years, while Italy was renowned for its rigid labor markets, high debt, and "frozen" social model. Nonetheless, in Spain the rise in unemployment was, from a much higher employment level, three times larger than in Italy, where the drop in GDP was actually considerably stronger. France, another country often denounced for being a slow reformer, saw no fall in employment or employment rates, but as demand remained flat and labor supply increased unemployment grew to high levels. Also, in other cases with extensive welfare states—such as Sweden, Norway, and the UK—the labor markets weathered the slowdown relatively well, regardless of their very different labor market regimes. The same also applies to Germany, where solid growth in exports and domestic demand was accompanied by strong rises in employment rates. Thus, how strongly the countries' labor markets were hit by the crisis evidently had little to do with their social models, as it resulted from the malfunctioning of deregulated financial markets irrespective of the strictness of labor market regulation or the size of the welfare states.

However, in the hardest-hit countries, the labor market fallout was clearly influenced by the social models, although differently than suggested by the EU's view and policy responses. The fall in employment (especially relative to GDP) was particularly strong in the liberal labor market of Denmark and in countries with liberal regulation and high shares of temporary work, typically Spain and the Netherlands. It is yet to be ascertained, however, to what extent this can be attributed to their lax dismissal rules for short-term labor or to the drop in domestic demand due to the deleveraging of private debt and ensuing cuts in welfare expenditure. For instance, in the UK and Sweden, which also have liberal, or partially liberalized, labor markets, employment held up much better in spite of steep initial downturns. Thus, part of the explanation is probably that they could invoke national monetary tools to improve competitiveness and avoid the deep drops in domestic demand seen in the former countries, at the same time as the UK, in contrast to its Eurozone counterparts, had few problems financing its large sovereign debt.

To sum up, we find that both prior to and during the crisis, changes in employment and unemployment in our case countries are closely associated with demand growth. The relationship between employment and demand growth nevertheless differed substantially across countries and time in ways that suggest that labor market outcomes are also significantly affected by supply-side factors such as variations in labor supply and social models. The view that aggregate employment is boosted by partial labor market deregulation receives little support, however, while its compositional effects are also highly contingent on demand variations. Fitting poorly with the simple supply-side explanation of employment, these observations are consistent with our guiding hypothesis that the level and growth of employment is determined by the interaction between demand and supply factors, as argued in econometric studies ranging from Blanchard and Wolfers (2000) to Nymoen and Sparrman (2012).

11.3.2 *From Employment Outcomes to Distributive Effects*

A central aim of this study was to investigate how the past decades' evolution of social models has influenced inequality. As shown in the case studies, and confirmed by broader and more in-depth studies (OECD 2008, 2011a, 2013a; Atkinson 2008; Atkinson et al. 2010; Piketty 2014), over the past 25 years there has been a trend toward increased wage and income inequality in most industrialized countries—though at very different levels and rates. Although the rise in capital incomes—increasingly concentrated among the richest very small percent of the population—has become salient recently (Piketty 2014), the increases in income inequalities have mainly been driven by changes in the distribution of work and wages, which account for around 75 percent of household incomes in OECD countries (OECD 2011a: 22).[19] The distributive shifts in labor market outcomes are influenced by a range of factors, such as technological change, market integration, globalization, and change in household structures, but according to the OECD such factors are of minor importance compared to the changes in labor market and social policies—that is, in what we have termed "social models" (OECD 2011a: 40–41). In this section we review developments of wage and income inequalities in the decades prior to and during the recent crisis, and the role of the social models in cushioning or amplifying them.

PRE-CRISIS TRAJECTORIES OF INEQUALITY

How did inequality develop in our case countries prior to the crisis? Looking first at *wage dispersion* among full-time employees, Figure 11.9 shows that the ratio between the top and bottom wage deciles (D9/D1) increased in the

[19] Even among the top 10 percent, earnings from work account for the predominant share of household incomes, representing, for example, 70–85 percent of their incomes in Italy, France, Spain, and the US (OECD 2014c: Figure 3). In our case countries, the strongest rise in capital income as share of total household income among the top 20 percent was, from low levels, seen in the Nordic countries from the mid-1980s onwards (OECD 2011d; Figure 8). Yet, the share of total pre-tax income falling to the top 1 percent in the Nordic countries remained the lowest among our case countries, together with the Netherlands, standing at 7–8 percent in 2012 compared with 13 percent in the UK and Germany (OECD 2014c: Figure 1).

majority of countries, mostly in the 2000s.[20] The exceptions were Italy, France, the UK (in the late 1990s), and Sweden (in the 2000s). Except in Germany, however, the ratio between those with medium wages and those with the lowest wages (D5/D1) were mostly stable, and in more than half of the cases reduced. There were some inequality increases at the lower end in Denmark, Norway, and modestly in Finland (in the 2000s), but the real outlier was Germany, where wage inequalities widened over the entire period.[21] This occurred both in the top and the bottom, where German inequalities almost surpassed those in the UK. Thus, except in these four countries, the growth in wage inequality prior to the crisis was mainly due to changes in the upper part of the distribution. The largest wage differences between the top 10 percent and middle deciles in 2008 were observed in France, Spain, and the UK. The strongest increases in the D9/D5 ratio 2000–08 occurred in Switzerland, the Netherlands, and the UK, whereas France, Spain, and Sweden experienced slight decreases (OECD.stat). The changes during the crisis are analyzed in the subsequent section.

The rank order of the countries as regards wage dispersion among full-time employees did not change much in the decades prior to the crisis. At all points the largest wage inequalities were seen in the UK, Spain, and Germany, while the smallest inequalities were seen in Italy, the Nordic countries, and Switzerland. The only three countries with declining overall pay inequality—France, Italy, and Spain—all showed decreasing or flattening inequalities in the lower half of the pay ladder. In Spain and France there are statutory minimum wages—which were substantially increased in France—and collective agreements are habitually generalized, while in Italy it is prohibited by law to pay below the collectively agreed minimum terms. Among the other countries with decreasing or flattening pay inequality at the lower end, it is notable that the UK introduced a statutory minimum wage in 1997, Switzerland broadened its practice of extending agreements in the 2000s, Sweden retained its exceptionally high bargaining coverage, and the Netherlands combined extension of agreements with a statutory minimum wage. In Germany, by contrast, where pay inequalities at the low end increased markedly, there was no statutory minimum wage while the use of agreement extension and the rates of unionization and collective bargaining coverage were diminishing fast (Bispinck and Schulten 2012), at the same time as the

[20] While the labor income share of GDP declined in most cases in 1990s, it was stable in most cases for 2000–08, except for a marked drop in Germany and the Netherlands, and a significant rise in France (OECD.stat).

[21] Also, the incidence of full-time low pay increased markedly in Germany prior to the crisis, reaching 18 percent in 2007 compared to 20.5 percent in the UK, but flattened during the crisis.

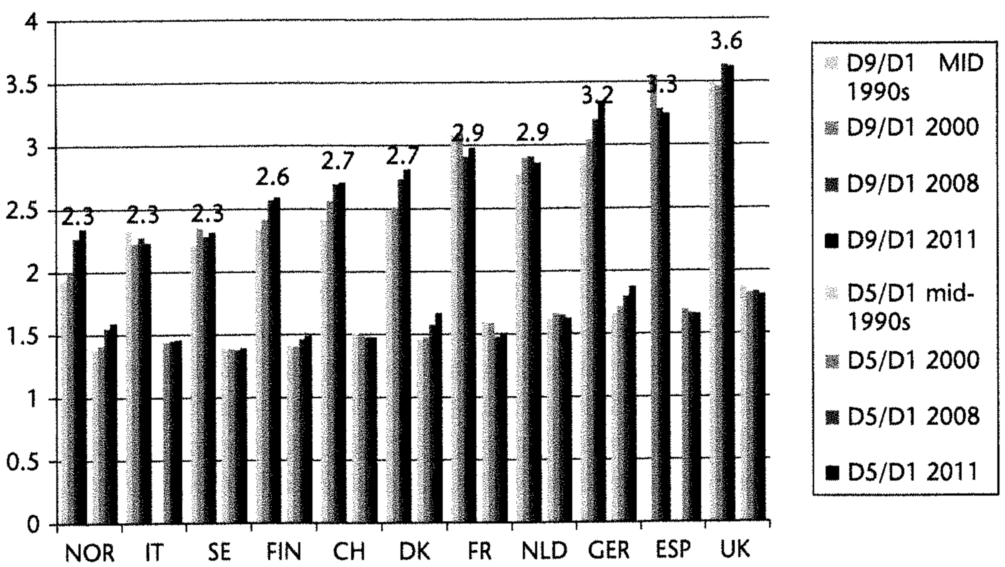

Figure 11.9 Gross wage inequalities D9/D1 and D5/D1 mid-1990s, 2000, 2008, and 2011* (Full-time employed, ranked by 2008 figures)

* France, Italy, and Netherlands 2010

Source: OECD.stat

Hartz reforms reduced the "reservation wage."[22] Also in Norway and Denmark, where pay inequality at the low end rose significantly in the 2000s, private sector bargaining coverage was low by comparative standards, and—except for a few branches in Norway—there was effectively no wage floor backed by statutory means (Table 11.1).

Clearly, the trends in wage inequality were significantly influenced by changes in the social models and the institutions of labor market regulation in particular, as is also shown by recent multivariate analysis of broader sets of countries (Rossvoll 2013; Koeniger et al. 2007; OECD 2011a).

As well as the expected effects of institutional factors such as bargaining coordination and coverage, unionization, minimum wages, and unemployment benefit duration, pay inequalities are shown to be compressed when the workforce skill structure is upgraded and to be significantly widened at the lower end when immigration and unemployment increase and employment protection for temporary employees is liberalized (Rossvoll 2013: 45; OECD 2011a: 101–4). In 2008, European fixed-term workers earned around 25 percent less than average workers with similar education, age, and hours worked,

[22] The German development can be seen as a prime example of what Barth and Moene (Chapter 10 of this volume) term the "inequality multiplier" stemming from the reciprocity between wage setting and welfare state institutions.

the gap varying among our cases from 36 percent in Germany to 19 percent in Norway (OECD 2012d). In addition, temporary jobs are over-represented in low-skilled occupations with low pay and tend to be associated with fewer working hours (Haüsermann and Schwander 2012: 33–34; OECD 2012c).

Inequalities in household incomes from earnings are influenced by national differences in employment rates and part-time shares as well as by wage disparities. In 2008, Gini indexes for labor earnings among full-time workers ranged from 0.28–0.30 in the Nordic countries and Switzerland, 0.33–0.35 in the Continental countries, to 0.40 in the UK. Taking differences in employment rates and part-time work into account, the variation in household earnings inequality in the working-age population becomes more polarized, clustering in two distinct groups (OECD 2012c). The Continental countries and the UK stood out with strikingly similar household earnings disparities (0.57–0.59), with Germany on top. The smallest disparities were still found in the Nordic countries (0.46–0.51), while France (0.55) and Switzerland (0.53) were located somewhere in the middle. Clearly, labor market inequalities are not only affected by the institutions of wage setting and employment regulation, but are strongly influenced by other supply- and demand-side factors shaping the volume and structure of employment. To capture the full impact of the social models on incomes inequalities (Figure 11.10), one also has to take into account the redistributive effects of the welfare state.

The redistributive effect of tax and transfer systems—i.e., their reduction of market income inequalities—has been weakened in most countries since the 1990s (OECD 2011a). In the mid-2000s, the effects were by far highest in the Nordic countries (roughly 40 percent reduction), followed by France, Germany, and the Netherlands (30 percent), and the UK (19 percent), while the effects were markedly lower in Italy, Spain, and Switzerland (Immervoll and Richardson 2011: 36–38). In addition, subsidized public services such as health, education, and care services—on average representing 13 percent of public spending in OECD—contribute to considerable redistribution and remained stable prior to the crisis (OECD 2011a: 39–40).[23]

By 2008, the four Nordic countries still showed the smallest household disposable income inequalities in the working-age population, while Italy, Spain, and the UK stood out with the largest (Figure 11.10). Over the 15 years prior to the financial crisis, income inequality increased in 6 of the 11 countries and decreased in 3—the Netherlands, Italy, and Spain. Inequality also decreased in the UK and Norway in the 2000s, but not in the 1990s. As most instances of declining disposable income inequality were in high inequality countries while most instances of increasing disposable

[23] Prior to the crisis (2007) such benefits in kind on average reduced income inequality by 20 percent (OECD 2012c: 40).

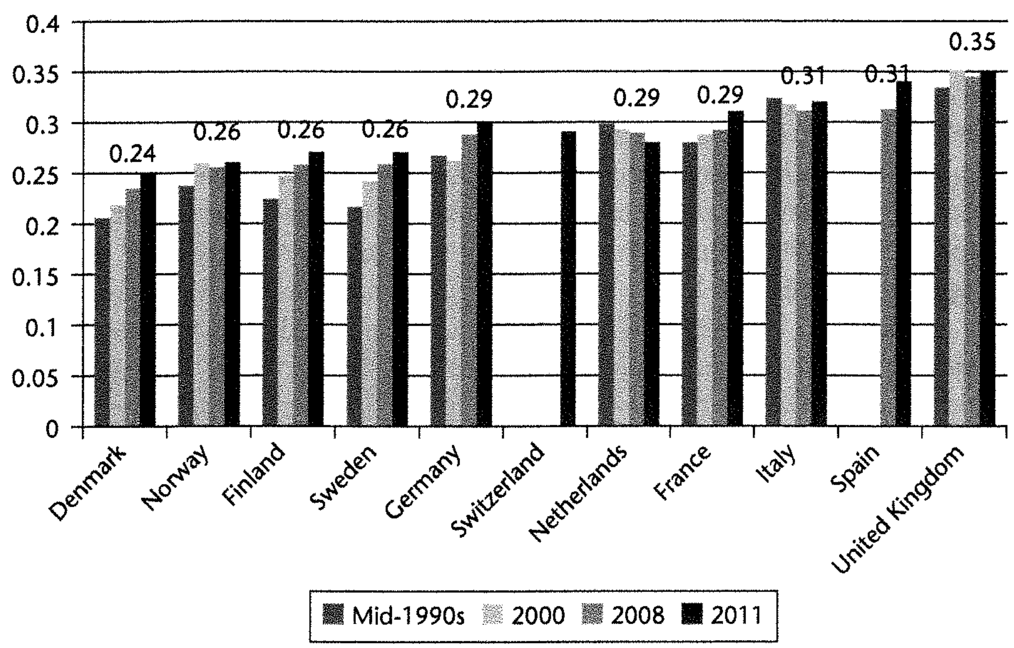

Figure 11.10 Working-age household income inequality after tax and transfers mid-1990s–2011, Gini index, ranked by 2008 figures (18–65 years)*
* For Spain 2004 is used as substitute for 2000

income inequality occurred in the low inequality Nordic cluster of countries, there was some convergence in inequality.

Comparing the rank order of wage and household income inequalities, the most striking differences were between Italy and Germany. In spite of low wage dispersion, Italian income inequalities in the working-age population were among the largest of the 11, presumably reflecting the low employment rate and rudimentary benefit system (although a slight reduction of inequality occurred from the 1990s onwards). Germany, by contrast, exhibited much lower inequality in household incomes than in wages, reflecting its comprehensive, targeted transfer system and the rise in dual-earner households (OECD 2011a). Still, with low job growth, high unemployment, rising wage dispersion, and growth in atypical work—alongside cuts in the benefit system—Germany had by far the strongest increase in income inequalities among the case countries from 2000 to 2008. When the employment recovery set in from 2005, however, this trend was arrested. In France, the low employment rate, more temporary work, and resilient high unemployment also contributed to some increase in income inequality in spite of reduced wage differentials, while the marked rise in income inequalities among the Nordic countries was much due to rising capital incomes in the top (Kvist et al. 2011).

The new literature on labor market "dualization" highlights the division between those employed in non-standard work and those in regular jobs as a major driver of inequality in post-industrial societies (Emmenegger et al. 2012). And even if the rights and conditions of non-standard workers vary across countries, OECD leaves no doubt that the deregulation of temporary work in Europe has contributed to growing earnings inequality (OECD 2011f: 31). However, in some countries the spread of such jobs came along with sustained job growth, improved employment opportunities and more hours worked, especially in working-poor households, and contributed to reduced inequality in household market incomes. In other words, the overall impact of non-standard jobs on inequality depends on the extent to which they have enabled employment of more people, on the one hand, and altered the composition of employment and the distribution of earnings and incomes, on the other. Advocating the "high employment route to less inequality," Kenworthy (2008, 2009) refers to the Netherlands and Switzerland as prime examples that the effect of increased employment can outweigh the compositional effect—i.e., that alongside stable relative wages in the lower end of the labor market, household income inequality declined in spite of increased shares of non-standard employment.

With modest (and mixed) changes in the wage structure and weakened redistributive effects of the tax and transfer systems (Immervoll and Richardson 2011), the pre-crisis decrease in income inequalities in the UK, Spain, and Italy can largely also be attributed to the growth in employment and labor demand. This lends support to Kenworthy's argument. At the other end, the increased inequalities in the Nordic countries in spite of solid employment growth are harder to interpret, but tax cuts and entrenchment of benefits enacted by center-right governments, especially in Sweden, alongside rising capital incomes at the top, growing immigrant populations, and increased segmentation at the low end of the labor market obviously had an impact.[24]

WIDENING INEQUALITIES DURING THE GREAT RECESSION

The crisis has been referred to as a "turning point" and a "game changer" with respect to inequality, firstly because it has been associated with accelerating inequalities within many countries, and, secondly, because, contrary to the preceding decades, it has brought growing income disparities between countries in the south and the periphery of the EU, on the one hand, and countries in the northern part of the EU/EEA, on the other (European Commission 2013b; Immervoll and Richardson 2013). Across this widening gap, more complex lines of divergence have emerged: in the EU-27, income inequalities measured by the Gini index fell on average 0.1 point 2008–11, whereas they

[24] The impact of taxation was also demonstrated when Norway in 2005 tightened taxation of profits on shares and then experienced a fall in income inequality 2000–08.

increased by 0.3 points in the Eurozone countries (European Commission 2013b).[25] The largest increases (2.7 points) came in Spain and, more surprisingly, in Denmark, two countries where the employment effects of bursting financial bubbles were particularly strong, while there was a flattening of income inequalities in the expanding economies in Germany and Norway.

At the time of writing, comparative inequality data are mainly available for the first years of the crisis. As the distributive effects tend to aggravate over the crisis sequence, it is instructive to look at the effects of deep recessions in the recent past. Referring (amongst others) to the crises in Finland, Sweden, Germany, and the UK in the 1990s, Immervoll and Richardson (2013: 10–12) show that any disruptions of the rise in market incomes for high-end groups were short-lived while the drops in the bottom were usually bigger and more long-lasting. The result was lasting widening of the income gaps. In the following we will therefore distinguish between the inequality effects in the crisis' first phase (2008–10)—primarily driven by the immediate job losses in the hardest-hit branches—and the second phase when the effects of reduced private demand after the credit bubble bursts and the turn to austerity from 2010 spread throughout the economies, and, in many instances, curbed the welfare states' capacity to cushion the social consequences.

The distributive effects on wage distribution in the *first phase* were primarily influenced by the income losses resulting from the initial collapse of manufacturing and constructions jobs around the middle of the wage structure, mostly held by male, full-time workers. In several of the debt-ridden countries where private demand contracted, this was also accompanied by job and income losses in low-end services jobs, often held by temporary employees. The effects on income inequality depended, secondly, on the affected groups' access to unemployment compensation and other benefits, i.e., the character of the welfare state, and on discretionary policy responses to cushion the effects. Besides expansionary macroeconomic policies aimed to stimulate demand, in several countries this entailed huge efforts to keep people in work by means of short-time work.

Prior to the crisis, job growth in the EU had been strongest in the top and the bottom of the job structure, and very limited in the middle, due to the decline in manufacturing. As the job losses in the first years of the crisis (2008Q2–2010Q2) were heavily concentrated in the middle (Hurley and Storrey 2011: 39), this accentuated the polarization of the job structure. In the EU as a whole the number of jobs in the top increased, while only a slight decline was seen in the lowest part of the job structure, but the shifts in the job

[25] Based on data from the EU-SILC survey (European Commission 2013b).

structure varied markedly.[26] With mostly unchanged wages in this phase, decreasing earnings in the top, and the loss of many of the lowest paid jobs, the result was a narrowing of wage dispersion in most of the harder-hit countries (Figure 11.9). The labor income share of GDP increased in all case countries, except Sweden 2008–10, reflecting the drop in capital incomes. However, as household market incomes declined substantially in most countries, and job losses disproportionally hit households in the lower half of the distribution, market income inequality rose markedly in all case countries, apart from Germany and the Netherlands in this phase (OECD 2013f).

Although prior changes had weakened the redistributive effects of the welfare states in many of the countries (OECD 2007, 2011a: 38),[27] the rise in market income inequality in the first phase of the crisis was to a considerable extent cushioned by the transfer and tax systems. Besides increased support for short-term work schemes, many countries adjusted eligibility requirements in the unemployment benefit systems to shield vulnerable groups. Italy in particular strengthened its patchy system of unemployment benefits.[28] Combined with the countercyclical macroeconomic policies in 2009–10, the consequence was that the effects on income inequality in most European countries were surprisingly modest in this phase of the crisis (Jenkins et al. 2011; Basso et al. 2011; OECD 2011a). Still, inequality increased substantially in France, Italy, and Spain in particular (Figure 11.10).

In the *second phase* of the crisis, the prolonged downturn in countries struggling with deleveraging of private debt and the contracting effects of the EU/EMU turn to austerity in 2010 unleashed another wave of job losses. By increasing the numbers of long-term unemployed running out of benefits and throwing workers from a broader range of sectors into unemployment—especially in the hard-hit countries cutting public jobs, wages, and benefits—this aggravated the distributive consequences of the initial downturn and drew attention to the political causes behind the growing disparities. When the crisis dragged on, the effects of the weakening of the welfare states'

[26] Spain lost jobs at all levels, mostly in the middle. In Italy there was significant job growth in the bottom and losses at all other levels; in France and the UK there was growth at both ends, while Finland, Sweden, the Netherlands, and Germany experienced growth in the upper parts and decline in the others.

[27] Important here was the reduced generosity of benefits for the unemployed, where average net replacement rates over a 5-year spell out of work were reduced from 85 to 72 percent in Finland, 75 to 64 percent in Germany, and 65 to 61 percent in the UK from 1995 to 2005 (Immervoll and Richardson 2011:59). Except slight increases (57–61 percent) in France, toward 50 percent in Spain, from 4 to 8 percent in Italy, and inclusion of immigrant labor in Switzerland, the other cases undertook similar changes.

[28] No improvements were made in minimum income support (social assistance), however. In Denmark the center-right government decided in 2010 to reduce unemployment benefit duration from 4 to 2 years and to restrict requalification conditions. The implementation was postponed by the subsequent government, when the effects of the job crisis weighed in.

redistributive capacity and automatic stabilizer function prior to and during the crisis came to the fore.

Although varying markedly between southern and northern countries, most of the "old" EU/EEA member states had been distinguished by their comparatively high shares of GDP spent on social protection, providing quite strong shock-absorbing capacity (Dolls et al. 2010). During the current crisis, however, the development of social protection spending in the EU differed substantially from other advanced countries and also from previous recessions (European Commission 2013b: 12). This reflected the turn to austerity policies in 2010, followed by stricter economic governance rules. Such fiscal consolidation has, according to an IMF study of former episodes of fiscal contraction in 17 OECD countries 1978–2009, significant distributional effects by raising inequality, decreasing wage income shares, and increasing long-term unemployment (Ball et al. 2013). The study also indicated that spending cuts have larger inequality effects than tax increases. While social expenditure increased on average by 12 percent in the OECD 2007–11 and 20 percent in the USA, it rose only 8 percent in EU-27 and 7 percent in the Eurozone, and actually declined in 2011 and 2012 (Bontout and Lokajickova 2013: 9). Compared to the 2001–04 recession, social expenditure responded slightly more strongly to the downturn in the initial phase, but in 2011–12 the adjustment was way below the trend line, meaning that social spending was pro-cyclical and reinforced the downturn. Only in Sweden and Finland were there modest increases 2011–12, while there were substantial decreases in Spain, Italy, and the UK (Bontout and Lokajickova 2013: 17, 18). In this way, the turn to austerity weakened the social models' ability to cushion the inequality effects of the crisis, leading the Commission DG Employment to note that, overall, "the changes in the tax and benefits systems and cuts in wages led to significant reductions in real household incomes, putting a heavy strain on the living standards of low-income households in particular" (European Commission 2013b: 12).

The redistributive effect of welfare and tax systems for the working-age population, as measured by their reduction of the Gini index ranged during the crisis from 7 percent in Spain and 15 percent in Italy to 25–30 percent in Sweden and Finland (European Commission 2013b: 11; 2013c).[29] Thus, the austerity packages imposed on the hardest-hit countries aggravated inequalities across countries. In other countries, however, the impact of EMU rules was also soon felt. In Finland, faced with a severe second dip and deteriorating public finances in 2012 the SGP thresholds were coming close and the government shifted to more restrictive fiscal policies supplemented by some

[29] The estimated inequality reductions were 18–19 percent in the UK and France, 20 percent in Germany, and 22 percent in Denmark (European Commission 2013b: 11).

"structural reforms." There were similar effects in the Netherlands and Denmark, pegged to the Euro, while the French fiscal consolidation efforts based on tax increases received outspoken criticism from the Commission's economic policy arm. Evidently, not only was EMU's construction a part of the Euro-crisis' causes, it exerted strong pressures on member states to weaken their social models' capacity to counter its destructive social and distributive effects. DG Employment of the European Commission thus warned that the reduced automatic stabilizing function of the social systems during the crisis "could potentially endanger the economic recovery process" (European Commission 2013b: 12–14).

Wage inequalities for full-time employed did not change much up to 2011 (Figure 11.9), reflecting the impact of wage-setting institutions and regulations. The strongest rise came in Germany, which passed the UK as regards inequality in the lower half of the pay ladder. Contrary to the previous decade, there was also a marked rise in France. The same pertained to Norway and Denmark, whereas there was very little change in Finland, Sweden, and Switzerland. By contrast, wage inequalities decreased in the UK, Netherlands, Italy, and Spain, presumably reflecting job-shedding at the lower end. Hence, except in Denmark and France, it seems that the deterioration of the labor market in most instances had a compressing effect on the wage structure of the remaining full-time jobs up till 2011. However, with the effects of prolonged and rising unemployment during the second dip on power relations in wage setting—when the reservation wage dropped for long-term unemployed losing benefits[30]—this tendency is likely to be reversed when more updated data become available, especially in the countries being subject to "structural reforms" of wage setting and labor market deregulation.

The changes in *inequality of disposable household incomes* in the working-age population (18–65) during the crisis' first phase (Figure 11.10) differed from the trends in wage inequalities, underscoring the distributive effects of job losses and shifts in employment. This was most clearly the case in Spain where household income inequality surged despite declining wage dispersion. There were similar effects in Italy and France, whereas the income inequality effect of the widening wage gap in Germany was tempered by rising employment. All cases with significant rises in unemployment in the initial phase exhibited increased income inequalities, while little change occurred in better-faring Norway, Switzerland, and, at the time, the Netherlands.

[30] By 2013Q3 long-term unemployment had doubled from 2008, to 11.6 million in EU-27 and 9 million in the Eurozone, amounting to 49.1 percent of the unemployed and 5 percent of the Eurozone workforce. The latter ratio varied from 1–2 percent in FL, SE, NL, DK, and GER, 3–4 in the UK and FR, to 6–9 percent in IT and ES (European Commission 2013c).

During 2011–12, the renewed rise in unemployment brought continued increases in income inequality in Italy, Spain, and Denmark, and more modestly in France and Sweden, reflecting that losses of jobs and incomes disproportionally hit low-income groups—especially low-skilled workers, immigrants, and youth, which have almost twice as high unemployment rates as the total workforce in EU (European Commission 2013a: 2). Still, on average, inequality in disposable household incomes had by 2011 increased only slightly in the Eurozone—bearing witness to the growing south–north divergence—while it had fallen somewhat in the EU-27 (European Commission 2013b: 9). There was also little change in the risk of poverty, except in Spain and Sweden, but when compared with "anchored" poverty thresholds from 2008 there was substantial increases in most countries, most pronouncedly in Spain (European Commission 2013b: 24).

Also, according to more recent data including 2012, income inequality for the entire adult population as measured by the relative income shares of the upper and lower quintiles (S80/S20) was on average stable in the EU-27 and increased only slightly in the Eurozone between 2008 and 2012.[31] However, sharply rising inequality in the southern countries and reduced inequality in several northern countries accentuated the regional divergence (European Commission 2013a: 11–12). An exception to this pattern, however, was Denmark, which remained within the group with largest inequality increases. There were also marked increases in France and Sweden, while by 2012 Germany, Finland, the Netherlands, Norway, the UK, and Switzerland remained in the group with stable or decreasing inequalities as measured by the S80/S20 indicator.[32] The risk of poverty or social exclusion rose sharply in the southern countries and in Denmark and Sweden (European Commission 2013a: 13).

Altogether, the different data sources, measures, and time periods referred to above seem to draw a pretty consistent picture up till 2012. Regardless of the character of the social models, income inequalities were widening fast in the countries which experienced the strongest decline in employment—Spain, Italy, and Denmark, among our cases—while there were more limited increases in France and Sweden. In the other cases, income inequalities changed modestly in Germany and were stable or declining in the Netherlands, UK, Norway, Finland, and Switzerland. Evidently, the diverse developments in income inequality had more to do with the very different macroeconomic and employment developments than with the social models.

[31] Quintile shares understate inequality since the quintile averages obscure the upper and lower ends of the distribution but they serve as measures of inequality in the whole adult population.

[32] In the working age population (18–65), however, there were by 2011 notable increases in Germany and Norway as well (OECD.stat).

The growing labor market disparities within and across European countries during the crisis were not simply a matter of divergence between the core and the periphery of the Eurozone, but were also a function of the extent to which different countries became subject to homemade private asset bubble bursts, as illustrated by the Danish and Dutch cases. While such policy failures can occur regardless of the social models, and certainly both inside and outside the Eurozone—as witnessed by the Nordic bubbles in the 1990s—it seems from our cases that lacking monetary policy tools (as do the countries in the Eurozone and those being pegged to it) both increases the risk of such failures and decreases the possibilities for remedying the labor market consequences of them, as indicated by the smoother cushioning of the effects in the UK as compared, for example, to Spain, Denmark, and the Netherlands.

11.3.3 *A "Trade-Off" Between Higher Employment and Lower Inequality?*

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

From the above review of the developments in employment and inequality, it is hard to detect any systematic relationship between *wage inequality* and employment growth. Prior to the Great Recession, the group with the steepest rises in employment rates comprised countries with low (Finland), medium (the Netherlands), and high pay inequalities (Spain), while the group with little or moderate change in employment rates spawned both countries with large wage inequalities (Germany and the UK) and small inequalities (Sweden and Switzerland). As to the effect of *changes* in wage structure, there was much less employment growth in Germany, with fast-widening inequalities, than in France and Italy, where pay inequalities diminished. In the cases with strongest employment growth there was flattening wage dispersion and even decreasing inequalities at the lower end. Thus, when comparing the *levels* of employment and unemployment in 2008 (Figures 11.5 and 11.8), most of the cases with lowest pay inequalities were among the best employment performers (typically the Nordic and Switzerland), while several cases with medium to high pay inequalities (France, Germany, and Spain) remained in the group with low to medium employment rates. Also taking into account the cases deviating from this pattern—Italy, the Netherlands, and the UK, showing all possible combinations of low, medium, and high pay inequality and employment rates—it is hardly possible to reveal any systematic connection between employment performance and wage dispersion, not even in the lower end where increased pay differentiation is often commended in the name of job creation (European Commission 2012). Similarly, a comparison of 13 European countries and the USA found no correspondence across time between the incidence of low pay in a country and the total employment rate, nor did it find any direct link between the incidence of low pay and the employment rate of the low-skilled segment of the workforces (Salverda and Mayhew 2009: 139–40).[33] During the crisis the picture was equally variegated, with solid job growth both in cases with small (Switzerland, Sweden, and Norway) and large (Germany) pay inequality, while hard-hit countries saw falling employment regardless of wage structure.

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

Thus, when looking at employment rates, GDP growth, and disposable household income inequalities in the working-age population prior to the crisis (Figure 11.11), we find no indication that higher inequality is connected with higher growth in GDP or employment rates. To the contrary, all four cases with lowest income inequalities score high on both GDP growth and

[33] Similarly, the OECD (2006a: 165) found no relationship between high minimum wages and employment rates among persons with low skills (no secondary education); employment rates were as high in Denmark, the Netherlands, and France as in the US.

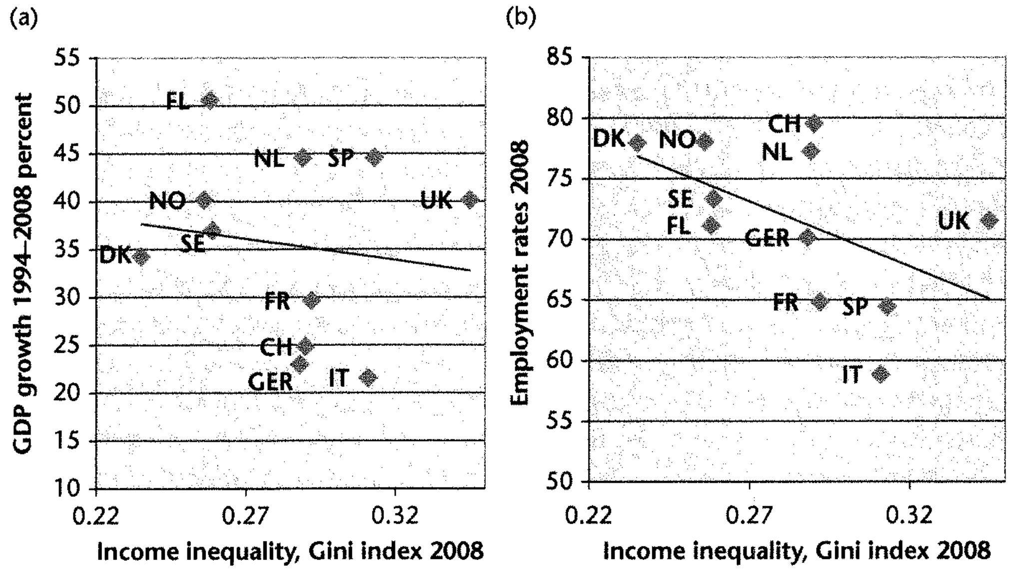

Figure 11.11 Change in GDP 1994–2008 (percent), employment rates 2008, and disposable household income inequality 2008 in working-age population (measured by Gini index)
Source: OECD.stat

employment levels (upper left quadrant of the graphs), while the cases with medium and high income inequalities are scattered around in all quadrants, as reflected in the slope of the regression lines. Clearly, "there is no simple link between inequality and growth" (OECD 2012a: 194), or, as concluded by a recent IMF study, "lower net inequality seems to drive faster and more durable growth" (Ostry et al. 2014: 4, 6). Among the cases with highest employment rates, four of five have low to medium inequalities and happen to be outside the Eurozone. By contrast, among those with lowest employment rates all have medium to high income inequalities and belong to the Eurozone.

The other way around, the cases with strong growth in GDP and employment rates (Figure 11.8), ceteris paribus, exhibited much lower rises in income inequality (Figure 11.10) than those with low growth in employment rates, indicating that widening income gaps were often a consequence of weak growth in the labor market rather than a cause of higher growth. Viewed together, these observations are in conformity with the expectation expressed in the Introduction that the effects of supply-side changes in the social models on distributive labor market outcomes are conditioned by the growth of labor demand. Further, they provide no indication that higher wage and income inequalities are associated with higher employment—lending no support to the thesis of a trade-off between equality and jobs.

11.4 Conclusion: Social Divergence and Monetary Integration

This chapter has provided a comparative review of changes in European social models over the past quarter-century. The central questions have been how these changes have interacted with changing economic conditions in influencing employment and labor market inequality; how the social models were affected by the financial crisis; and how the prior changes in them influenced the course of the crisis and the models' capacity to cushion its effects.

Starting with the final question, the answer is straightforward. Contrary to the common contention that the Euro-crisis was a result of overly generous, rigid, and unreformed social models, the severity of the crisis evidently had less to do with deficiencies in the social models than with the deficiencies of financial market deregulation and with the economic divergence generated by EMU's economic governance structure. Any social model impact on the labor market fallout of the crisis was dwarfed by the impact of the private debt bubbles bursting in several of the case countries—such as Denmark, the Netherlands, the UK, and Spain—and the resultant surge in public debt when governments were forced to rescue their financial system and socialize private debt.

Whether the hard-hit countries were drawn into the sovereign debt crisis and forced to slash welfare budgets and employment protection also had less to do with the pre-crisis level of social spending, budgetary deficits, public debt, or employment protection than with the mounting imbalances in trade and capital flows within the Eurozone. For instance, the main casualty, Spain, modernized its social model and underwent a revolution in (female) labor market participation in the preceding decade, entering the financial crisis with a budget surplus and lower public debt and social spending relative to GDP than Germany, France, and the UK. Italy, another casualty, had done less to adjust its social model, but the share of GDP spent on social protection in 2008 was similar to that in Germany and the budget deficit was lower than in the UK, although the persistent inability to collect taxes implied that the high level of state debt, largely to Italian citizens, was not much reduced and became impossible to service when default panic gripped the financial markets. In spite of these contrasting budgetary positions, employment dropped six times more in Spain than in Italy.

Next to Spain, the strongest falls in employment among our cases occurred in Denmark and the Netherlands, which had long been hailed for their "flexicurity" models and "employment friendly" welfare states. Rather than profligate social spending, the mass job losses were caused by bursting housing and banking bubbles. Fueled by "privatized Keynesianism" (Crouch 2011) politically enhanced by tax reliefs, liberalized credit, loss of monetary instruments to curb such lending sprees, and the absence of EMU- wide regulation coterminous with the integrated financial market, the downturns were aggravated by the turn to

austerity in compliance with EU rules and recommendations. A similar sequence was seen in the UK—with its prototypical liberal social model—compounding the fact that the crisis hit indiscriminately as far as social models were concerned. Yet, in contrast to the former cases, the UK could invoke monetary tools and benefit from substantial currency depreciation, bridging the slump more swiftly than the afflicted countries tied to the Euro.

Although the nature of the social models had little impact on the depth of the crisis, it had significant impact on the ability to cushion the effects of the slump. Strikingly, the cases with the largest labor market fall outs—Spain, Italy, Denmark, and the Netherlands—were all distinguished by liberalized temporary work, and (except Denmark) strict protection of permanent workers. The same dualism is true of Sweden, where unemployment in spite of healthy growth stabilized at higher levels than harder-hit countries such as Denmark. Besides withdrawal of youth labor supply, the relatively low open unemployment in Denmark reflected that it spent almost twice as high a share of GDP on active labor market programs as any other EU country—illustrating how robust welfare states could cushion the crisis' effects. Further striking was that actors in countries with well-organized systems of employment relations seemed more apt to negotiate innovative ways to retain labor during the trough, such as the short-time work schemes and emergency pacts flourishing, amongst others, in Germany, Finland, and the Netherlands. In Sweden, unions and employers established a similar scheme through collective bargaining.

The tax and transfer systems' ability to cushion the income inequality effects of unemployment varied starkly between cases with encompassing welfare systems, typically the Nordic, Dutch, and French, and the more patchy unequal systems in Italy and Spain where sweeping cuts during the crisis magnified the effects. Still, as witnessed in France and Nordic countries, hardly any social model can curtail the disparities arising from mass job losses and prolonged, high unemployment. While prior changes had weakened the automatic stabilizing and cushioning effects of tax and welfare systems, the impact was—especially in the countries subject to treatment by the Troika—aggravated by the welfare cuts ensuing from the EU shift to austerity. Contrary to the diagnosis implied by the EU/ECB recipe for austerity and "structural reform," our study suggests that countries with well-organized systems of employment relations and skill formation, relatively un-segmented labor markets, and encompassing welfare states with adequate tax and funding systems, ceteris paribus, were better equipped to weather the crisis than countries with leaner and less coherent social systems.[34]

[34] Defining labor market "resilience" as the extent to which "labor markets weather economic downturns with limited social costs" in terms of "unemployment, labour income and earnings

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

Altogether, our comparative analysis of the pre-crisis period lends limited support to the supply-side diagnosis dominating European labor market debates the past decades. As there was no association between the increase in employment and the level of inequality across countries, we found no evidence of a trade-off between equality and jobs. The Nordic countries still stood out, with the lowest inequalities and highest employment levels measured in worked hours relative to working-age population. While there is clearly "no simple link between inequality and growth" (OECD 2012a: 194), evidence compiled by the IMF seems to suggest that higher net inequality hampers growth (Ostry et al. 2014: 4, 6). Neither do our findings lend support to diagnoses focusing solely on the demand side. Labor market outcomes are obviously influenced by demand—as demonstrated during the recent crisis—but the vast pre-crisis variations in the employment effects of growth were clearly influenced by supply-side factors. The "employment miracles" in Spain, the Netherlands, and lately in Germany were enabled by prolonged, solid growth, but they could hardly have been sustained without the untapped reservoirs of labor supply among women in particular. As shown in the Nordic countries a few decades earlier, investment in social models enabling broader labor market participation, skill formation, and combination of work and family life evidently contributed to the supply-side responsiveness to the rise in demand. That similar dynamics did not occur in Italy, France, and Germany in the 1990s and early 2000s strengthens our confidence in the view that sufficient demand is indispensable to mobilize untapped labor supply and boost employment. In conclusion, our findings conform with the proposition that labor market outcomes are determined by the interaction of supply- and demand-side factors (Blanchard and Wolfers 2000).

From this perspective, it is incomprehensible that, in the face of the recession unleashed by collapsing demand in the wake of the financial meltdown, the EU/ECB have further depressed demand by enforcing austerity while pressing for "structural reforms"—the only strategy for coping with the labor market crisis prescribed by the supply-side diagnosis to which European policy-makers reverted after initially responding to the crisis by stimulating demand (Chapter 1, Section 1.2.1).[35] This "wrong-headed eurozone economic policy," as the *Financial Times* (2014a) puts it, has been having a more powerful impact on social models and labor market outcomes in some of our case countries than others. These variations reflect the fundamental transformation of the political framework shaping social model changes between the two crisis periods. After the first, the policy responses were largely shaped by national institutions and party politics. By the time of the second, monetary integration and the parallel augmentation of EU authority had altered the political framework for economic policies and social model adjustment, varying significantly between countries inside and outside EMU. Whereas the latter have been able to continue deploying national monetary tools, including exchange rate adjustments, to overcome economic shocks, the former, after ceding monetary policies, have been subject to successively stricter constraints in fiscal policies. Hence, the only strategy for responding to economic shocks or dampening cyclical swings left to them is "internal devaluation"—i.e., adjustments in tax and transfer systems, wage setting, and the labor market pillars of the social models.

inequality," a similar conclusion is drawn by the OECD (2012c: 54). In models with weak or no coordination of wage bargaining and liberal rules for, and high shares of, temporary work (typically Spain), a given drop in GDP has a much stronger negative impact on resilience than where bargaining is more coordinated and non-standard employment is more regulated.

[35] Jones 2013 systematically analyzes the place of "structural reforms" in the EU/ECB economic policy strategy.

Such differences have been reflected in markedly different patterns of social model change between our case countries inside and outside the Eurozone. In the latter countries monetary policy has eased the pressures on the social models—eventually also shielding them against the sovereign debt crisis—mainly leading to incremental adjustments in the social models. Absent national monetary policy, social model development in the Eurozone countries has become much more directly affected by macroeconomic volatility and has been strongly influenced by growing economic divergence. After the reunification crisis, strong growth gave ample room for development of the social models in Finland, the Netherlands, Spain, and other countries in the EMU periphery, in contrast to the large core countries struggling with low growth. Combined with the reunification shock, this prompted the substantial overhaul of the German social model. In the second phase, the economic divergence and ensuing debt crisis opened new social and political cleavages in the EU. While the southern countries that fell victim to the sovereign debt crisis were subordinated to administration by the Troika and forced to make drastic inroads in their social models, the northern "surplus" countries were still able to comply with the tightened EMU rules by means of limited "internal devaluations."

Common to all, however, is that the weight-shift between national and supranational politics, and the multiplier effects of the permanent austerity regime installed by the EU, will reshape social model evolution in ways rendering earlier analyses of the EU as a rescue of the national welfare state obsolete (Milward 1990; Ferrera and Gualmini 2004). Although the "European social model" may not be "already gone" as ECB President Draghi (2012) contended, the EU/ECB economic strategy has put the EU on a downward slope toward an increasingly multi-tiered Europe. In such a scenario the divergence in the political and economic conditions for development of the social models among debt-stricken Euro-countries, better-faring Euro-countries, and countries outside the Eurozone is likely to deepen, defeating the Treaty aspirations for upward convergence toward a "Social Europe." Across these tiers, however, economic spill-overs, "regime competition," and rising movements of labor and services can be expected to put a chill on inequality-decreasing reforms in better-off countries as well, and to entail an obvious risk of a vicious circle of downward convergence. With prospects for a protracted, slow, and uneven recovery, this suggests that most national politicians and social partners will have to fight over the distribution of burdens and sacrifices rather than such reforms. If so, the EU response to the crisis may turn out to be a turning point whereby the past 50 years of social progress gives

way to dynamics of social division and regression that may spread throughout the EU and beyond. The looming risk is that such dynamics will also make more people turn their back to European integration and the political cooperation across borders that, more than ever, are needed to restore the economic growth on which employment and distributive justice across all of Europe depends.

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