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The Self-Transformation of the European Social Model(s) *

European welfare states are in varying need of reform. Intensified international competition, ageing populations, de-industrialization, changing gender roles in labor markets and households, and the introduction of new technologies, all pose severe strains to welfare state programs designed for a previous era.

All European welfare states share three distinctive characteristics. Normatively, there is a *common commitment to social justice*. The vocabulary of reform is in most member states couched in terms of a solidaristic commitment that society will not abandon those who fail. The aspirations of full employment, universal access to health care and education, adequate social insurance for sickness, disability, unemployment and old age, and minimum resources of social assistance to prevent poverty and reduce social exclusion, are widely accepted by European publics and deeply entrenched in policy program and institutions (Boeri, Borsch-Supan, and Tabellini, 2001).

At the cognitive level, the European social model is based on the *recognition that social justice can contribute to economic efficiency and progress*. Against the neo-liberal assumption of a big "trade-off" between economic efficiency and social justice, European policy elites agree that social policy is an essential factor in promoting economic adjustment, that there is no contradiction between economic competitiveness and social cohesion. In the face of market failures the welfare state is able to insure social risks that private insurance cannot adequately cover (Barr, 2001). In addition, it can reduce economic uncertainty, enhance the capacity to adjust and the readiness to accept change, bear more risks, acquire specialized skills, and pursue investment opportunities. Moreover, social policy serves to channel industrial conflict in periods of structural adjustment (Streeck, 1997). Last but not least, with social protection outlays averaging 28 percent of GDP in the EU, the welfare state acts as an effective anti-cyclical stabilizer (Begg et al, 2001).

Finally, the European social model is marked by *high degrees of interest organization and comprehensive negotiations* between the government and the social partners over conflicts of interests in matters of economic and social policy. Compared to North America, industrial relations are stable; the majority of workers are covered by collective agreements determining

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working conditions, employment protection, and living standards. Social partnership, with "trust" as a constitutive element encourages a problem-solving style of policy making, rendering collective actors the necessary social capital to overcome sectionalist interests (Ebbinghaus and Hassel, 1999; Swank, 2001).

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

(With fifteen different welfare states, not to forget a possible enlargement with ten candidate countries, there obviously does not exist any single "European social model" towards which member states of the European Union could possibly converge in the next decades. Clearly, the issue is not one of subordinating domestic policy to EU directives but rather one of joint policy learning and cooperation.)

We do live in a world of path-dependent solutions, and therefore radical change in Europe's welfare states is indeed institutionally ruled out. Throughout the neo-liberal 1980s it proved difficult to launch a successful attack on the mature welfare states, especially in Western Europe. Growing citizen disenchantment with neo-liberal recipes subsequently led to political reversal in the 1990s. Voter reaction against the social costs of widening wage disparity and rising poverty revealed a deep popular commitment to their welfare states. This helped return social democratic parties to office in the majority of West European polities, including the four largest countries. The character of the reforms pursued under Center-Left governments in the 1990s is best captured in terms of institutionally bounded policy change. Altogether, the European welfare states, based on the principles of social justice and equity as a source of economic competitiveness, embedded in political institutions favoring negotiated reforms, have proven to be far more responsive than is generally given credit for. As prevailing employment and social policies ran into severe problems of sustainability, because they were built on political, economic, demographic, and household conditions that no longer prevailed, this triggered a dynamic of renovation and re-casting of current policy so as to achieve a better " fit" with new societal challenges and pressing economic constraints. Moreover, the precise policy mixes that have ensued reveal that the underlying normative, cognitive and institutional principles of the European social model are fairly robust. But most important of all, the reform experience shows that welfare policy adjustment has not only been shaped by past policy legacies and institutional structures of decision-making, but more critically by policy makers' capacity for innovation, intelligently using the normative, cognitive and institutional resources at their disposal (Crouch, 2001).

Welfare Regimes and the Service Sector Trilemma

We can identify three welfare regimes, each with a rather unique welfare design and institutional attributes, based on deeply held national aspirations of equality, social justice and solidarity: a Nordic, an Anglo-Saxon, and a Continental European model. The three vary significantly in their relative vulnerability to the new challenges of post-industrial change (Esping-Andersen, 1990; 1999; Ferrera/Hemerijck/Rhodes, 2000).

The comprehensive *Scandinavian welfare states* are characterized by citizenship-based universal entitlements; generous replacement rates in transfer programs; general revenue financing; a broad supply of social services beyond health and education, active family policy encouraging gender egalitarianism and women's integration in the labor market; low (Denmark) to high (Sweden) levels of employment protection, with a strong emphasis on active policies and training programs linked to general education; and corporatist industrial relations with peak level bargaining, strong unions and high levels of collective bargaining coverage.

The *Anglo-Saxon model* is characterized by a bias towards targeted, needs-based entitlements ; low replacement rates in transfer programs; general revenue financing; underdeveloped public social services beyond health and education; poor family services; low levels of employment protection, largely confined to ensure fair contracts, and no legacy of active labor market policy, nor vocational training and education; uncoordinated industrial relations with moderately strong unions, decentralized wage bargaining, and low levels of collective bargaining coverage.

The *Continental European model*, historically influenced by a mix of etatiste, corporativist and familialist traditions is characterized by occupationally distinct, employment-related social insurance; very unequal levels of generosity in transfer programs, combining generally very high pension replacement rates with occasionally very modest income support (such as unemployment benefits in Italy); a contribution-biased revenue dependency; very modest levels of public social services beyond health and education and often a considerable reliance on "third sector" and private delivery; passive family policies premised on the conventional male breadwinner family; generally strict levels of employment protection, that is meant to protect, once again, the male breadwinner combined with passive labor market policies, but comprehensive systems of vocational education and training, especially in Germany, Austria, and the Netherlands; strong social partnership that extends into the administration of social insurance; and coordinated industrial relations, with a predominance of sectoral wage bargaining, with high levels of bargaining coverage and moderately strong unions.

Differences in policy design are closely related to variations in employment performance, service intensity, levels of income inequality, and also to structures of taxation. On the employment side, the Nordic countries outperform both the Anglo-Saxon and Continental models (see Table 1). Ireland and the United Kingdom display favorable levels of employment with relatively low rates of public employment (but in Ireland, female employment is very low). The Continental European countries present a mixed picture, with above average employment performance in the North-Western part of the European continent, including Austria, Belgium, France, Germany, the Netherlands and Luxembourg, and very low employment rates (especially among women and older workers) in the Mediterranean countries (Portugal being an exception).

Table 1: Employment Performance in the European Union (2000)

	Employment rate 1998[a]	Un-employment rate 1997[b]	Long-term unemploy-ment 1996[c]	Female employment rate 1997 [b]	Youth un-employment rate 1995[e]	Activity rate, men aged 55-64 1998b	Public Em-ployment Ratios 1995[d]
Denmark	76.3	4.7	1.0	71.6	5.3	61,1	22,7
Finland	67.5	9.8	2.8	64.4	11.2	44,4	14,6
Sweden	73.0	5.9	1.3	71.0	5.5	71,4	21,9
Austria	68.3	3.7	1.0	59.4	2.9	42,5	10,0
Belgium	60.5	7.0	3.8	51.5	6.5	33,9	10,3
France	62.2 [f]	9.5	3.8	55.3 [f]	7.1	41,3	14,5
Germany	65.4 [f]	7.9	4.0	57.9 [f]	4.6	55,6	9,3
Greece	55.6 [f]	11.1	-	40.9 [f]	-	57,0	6,9
Italy	53.5	10.5	6.4	39.6	11.8	42,6	8,9
Luxembourg	62.9 [f]	2.4	0.6	50.3 [f]	2.5	35,1	-
Netherlands	73.2 [f]	2.7	0.8	63.7 [f]	3.6	46,9	6,8
Portugal	68.3	4.2	1.7	60.3	4.2	67,3	12,0
Spain	55.0	14.1	5.9	40.3	11.4	57,7	7,5
Ireland	65.1	4.2	1.7	54.0	3.3	63,0	9,3
UK	71.2	5.5	1.5	64.6	8.3	62,6	9,5
EU 15	63.3	8.2	3.6	54.0[f]	7.8	52,2	11,7

[a]Total employment/population 15-64 years; [b] Standardized Ratio; [c]Long-term unemployed (12 months and over) as % of labor force; [d] % of population 15-24, 1998; [e] Unemployed as % of population aged 15-24.
Source: Employment in Europe 2000, European Commission, 2000a; OECD (1999a) (Public employment figures) OECD, Employment Outlook 1999.

With respect to social expenditures, the Nordic countries, as shown in Table 2, are by far the most generous, followed by Continental Europe with the Anglo-Saxon countries occupying the low end. The spending bias differs, however. The Mediterranean countries are very pension biased, most notably in Italy where pensions absorb 16.13% of GDP. In contrast, the Nordic welfare states are unusually biased in favor of social services to families and children.

Table2: Levels of Social Security, Active Labor Market Policy, and Collective Bargaining Coverage in the European Union

	Social expenditures in percent of GDP 1998[a]	Total taxation in percent of GDP 1997[b]	Old Age and Survivors as percent of GDP 1998[a]	Family/ Children as % of GDP 1998[a]	Coverage Collective Wage Bargain 1999[f]
Denmark	30.0	52,2	11.49	3.90	0,52
Finland	27.2	47,3	9.38	3.48	0,67
Sweden	33.3	53,3	13.12	3.60	0,72
Austria	28.4	44,4	13.69	2.84	0,97
Belgium	27.5	46,5	11.77	2.34	0,82
France	30.5	46,1	13.42	2.99	0.75
Germany	29.3	37,5[c]	12.69	3.03	0,80
Greece	24.5	40,6	12.89	1.98	-
Italy	25.2	45,0	16.13	0.91	-
Luxembourg	24.1	-	10.65	3.40	-
Netherlands	28.5	43,3	11.71	1.28	0.79
Portugal	23.4	34,5	9.99	1.24	0.80
Spain	21.6	35,3	9.96	0.45	0.67
Ireland	16.1	34,8	4.01	2.04	-
United Kingdom	26.8	35,3	11.77	2.30	0,35
Average	27.7	42,6	12.66	2.30	

[a]1998 [b]1997; [c]1996; [d]1995, workers covered, figures not including Greece, Italy, Luxembourg, and Ireland; [e]1995 data, or latest year available;

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Sources: [a]Eurostat (2000): *Statistics in Focus: Social Protection in Europe*, Theme 3-15/2000.; [b]OECD (1999c): *Benefit systems and work incentives,* own calculations; [c] Social Protection Expenditures and Receipts, European Commission/Eurostat (there may be some overlap with other categories of expenditure); [d] [e] OECD Online Social Expenditure Database; [f] Ebbinghaus/Visser, 2000.

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

The problems which beset different welfare regimes are inevitably connected to the nature of de-industrialization and the rise of the service sector. Persistent unemployment remains the Achilles heel of most European economies. Although it has declined from its peak of 11.1 percent in 1994 to less than eight percent in 2001, long-term unemployment remains at four percent of the labor force. More than forty percent of European unemployed people have been out of work for more than a year. Employment growth is skill-biased, service intensive, and gender-specific. The highly educated workers are the winners, both in terms of job security and pay. The low skilled and less experienced workers are the losers; they either face declining wages, as in the U.S., or rising difficulties in finding employment.

(Maximizing worker productivity may have resulted in a general "inactivity trap", whereby a virtuous cycle of productivity growth coincides with a vicious cycle of rising wage costs and exit of less productive workers, all requiring further productivity increases and eliciting another round of reductions in the work force through subsidized early retirement exit.)

The dynamic of de-industrialization is related to the longer run dynamics of exposed and sheltered sectors (Scharpf, 1997a). Since the mid-1970s, European economies, with the notable exception of the Netherlands and Ireland, have experienced substantial employment decline in the exposed sectors, especially in agriculture, mining, manufacturing and transport. Within the sheltered sectors, in turn, there is the perspective of expanding employment in services like wholesale and retail trade, restaurants and hotels, community-, social-, and personal services. These should benefit from the new demand structure that comes from population aging (health, care services, and recreation), from household transformation (dual career households are more inclined to buy personal services), and from increased female employment which generates demand for "reproductive" social services, such as childcare.

The combination of de-industrialization, the rise of the service sector, and the fiscal constraints that derive from the EMU, pose a thorny trilemma. Iversen and Wren (1998) argue that the goals of high levels of employment, income equality, and fiscal restraint can no longer be achieved simultaneously. The service sector trilemma generates quite distinctive policy problems for different welfare systems.

The Scandinavian Problem

The Scandinavian welfare states are expensive in terms of revenue requirements, but they are demonstrably better adapted to the exigencies of post-industrial change – due to their service intensive, women and child "friendly" public policy profiles. Social exclusion due to poverty and long-term unemployment is largely avoided. Denmark and Sweden embarked on the road to high public employment already in the 1960s, and what emerged was a self-reinforcing mechanism emerged whereby the expansion of "welfare-state jobs" encouraged women and lone parents to enter the labor market. The net result was near-maximum employment among men and women alike, less early retirement, and relatively high birth rates, all helping to reduce the long-term financial strains on pension systems.

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

The Anglo-Saxon Problem

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

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

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

The Continental European Problem

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

The vulnerability of most Continental welfare states lies less in the Anglo-Saxon ills of widespread poverty and problems of skill formation, and more in their chronic inability to stimulate employment growth. Job stagnation is directly related to the particular method of payroll-based social insurance financing. This breeds a complicated, mutual interaction between investments, productivity, labor supply, and wage costs. The key to this interaction lies in the strategy of boosting international competitiveness via a combination of early retirement and raising productivity levels of workers through high-quality vocational training and education. The strategy may have put a premium on high productivity, but the indirect effect has been a substantial increase in the "tax" on labor, as ever fewer workers must shoulder ever more inactives. Put differently, maximizing worker productivity may have resulted in a general "inactivity trap", whereby a virtuous cycle of productivity growth coincides with a vicious cycle of rising wage costs and exit of less productive workers, all requiring further productivity increases and eliciting another round of reductions in the work force through subsidized early retirement exit. The inactivity trap of the Continental welfare states reinforces existing insider-outsider cleavages and social exclusion, especially where labor markets are heavily regulated, as in Southern Europe. The primary victims of this self-reinforcing negative spiral have been the young and women (women with children, especially). This goes a long way to help explain low fertility especially in the Mediterranean countries. Like elsewhere, with rising education women's preferences have changed dramatically. But unlike elsewhere, the institutional environment has remained 'frozen' in the traditional male breadwinner mold. In brief, overall job stagnation is worsened by the severe incompatibilities that women face when they opt for a career.

Countries all face the service sector trilemma in one form or another. Still, we should avoid exaggerating its actual ramifications. More concretely, it may act as a general constraint but it is not necessarily insuperable. Over the past decade, some countries, among them Denmark and the Netherlands, have managed to increase service jobs while essentially returning to full employment *without* abandoning their commitment to either wage equality or fiscal restraint. Indeed, both countries have in recent years built up substantial budget surpluses. This also applies to Sweden and Finland which, considering the deep economic crisis of the 1990s, confronted intense budgetary strains *and* a rise in unemployment.

Bounded Innovation in the Welfare State

Welfare reform is difficult, but it happens. Before policy alternatives are placed on the political agenda, the status quo must be considered unsatisfactory. Crises often trigger processes of policy learning while policy mistakes can energize the policy process by allowing political decision-makers to overcome institutional rigidities. The cathartic experience of the "Dutch disease" in the early 1980s is a good example of how policy mistakes generate positive learning effects: After a lengthy and painful period of immobilism, a process of self-correction in the Netherlands spurred a remarkable economic recovery without sacrificing core welfare goals (Visser/Hemerijck, 1997). Italy's political and economic crisis in the early 1990s, which led to a comprehensive redesign of the Italian pension system, was to a large degree fostered by the challenge of EMU (Ferrera/Gualmini, 2000). Typically, reforms are preceded by deep political crises, major hikes in unemployment, government deficits, exchange-rate pressures, and irresistible economic and political imperatives like EMU participation.

Policy failures, however, are not a sufficient condition for policy change. The capacity to translate a crisis into bounded policy innovation depends on political forces and institutional factors. Majoritarian political systems, like in the United Kingdom, give single-party governments the mandate to adopt radical and comprehensive reform. The consensual German and Dutch democracies, based on proportional representation with multi-member constituencies and coalition governments, are more biased towards slow, incremental, disjointed and negotiated patterns of policy change because of the many veto players that need to be accommodated.

(It is striking how many reforms have been enacted in the past decade and how little they followed the textbook neo-liberal prescriptions.)

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

Policy innovation can remain within the bounds of the prevailing logic, principles, content and institutional format of previous policy. This implies essentially instrumental and incremental change. More daring reforms include changes in the institutional rules of the game and/or changes in the goals and principles of policy. Finally, when change fails to establish a workable equilibrium, this often prompts domestic political actors to change the entire policy paradigm.

This often goes with an enhanced interest in "best practices" adopted elsewhere. In the early 1980s, the Irish followed the British strategy of radical labor market deregulation. After government officials, trade unionists and employers discovered that this strategy was ineffective in countering industrial decline, Irish policy makers shifted to comprehensive social pacts (Hardiman, 2000).

EMU and the Wage Bargain

Economic and Monetary Union (EMU) forced member states to commit to budgetary discipline within the constraints of three percent of GDP for the deficit and sixty percent for the debt. It has inaugurated a more stable economic environment, and to a more closely synchronized EU business cycle.

With the completion of full monetary integration, it is feared that tax competition will intensify, leading to an under-provision of public goods (Genschel, 2001). In order to attract and preserve capital, countries will feel pressed to provide advantageous taxation and/or regulation for internationally mobile firms. Other countries will follow suit, which in the end will cause a lower level of taxation and regulation than was previously found appropriate. Such developments would in the long severely jeopardize current systems of social protection (Tanzi, 1998). The empirical evidence, however, suggests that tax competition has so far been limited. Firstly, there has been no decrease in total taxation levels across Europe. Secondly, there is no clear indication of a shift from taxing mobile to immobile factors. Empirical data show that while property and consumption taxes have declined, corporate taxes have gone up. Some conclude, therefore, that there is no significant pressure on taxation (Garrett, 1998; Swank, 2001). But this may be misguided. For one, when we consider increasing unemployment, rising poverty, expanding pensions and health care costs, we would have expected that taxation should have risen. Instead, during the 1980s most welfare states turned to deficit spending. If countries were not affected by tax competition, they would not have been forced to seek recourse to deficit financing rather than more taxation in order to finance higher spending requirements. There is no evidence that governments have been pushed into a "race to the bottom". But, caught between fiscal strain and the need to address new social risks, significant adjustments were required in order to sustain European welfare states so as to lower the burden on the public budget and to dampen the growth of wage costs. The Maastricht criteria clearly operated as triggering devices, helping to overcome political resistance to unpopular reform. Italy in this respect is exemplar. The Italian welfare state was in effect "saved by Europe".

But these new constraints have not provided policy makers with a "window of opportunity" to launch bold strategies of labor market deregulation. To the contrary, EMU seems to have spurred a resurgence of national social pacts aimed at ensuring welfare-state sustainability. (Fajertag and Pochet, 2000; Ebbinghaus and Hassel, 1999). This process began in the Netherlands with the 1982 "Wassenaar accord", followed by the 1992 "New Course" agreement and the "Flexicurity Accord" of 1996. Denmark established more informal norms of wage moderation under the D-Mark zone in 1987. Finland followed suit with the "Stability Pact" of 1991. Ireland embarked on a series of tripartite accords in the late 1980s, beginning with the "National Recovery" accord in 1987 through to the "Partnership 2000" agreement reached a decade later. In Italy, the first pact was the "National Agreement" on the scala mobile in 1992, followed by pension reform in 1995 and the "Social Pact for Growth and Employment" of 1998. In Portugal a number of agreements were reached throughout the 1990s (without consent from the largest union). In Spain important agreements include the "Toledo Pact" of 1996, and the "Stability of Employment and Bargaining Pact" of 1997 . Especially for hard-currency latecomers, like Italy and Portugal, and Greece, EMU helped to rekindle cooperative, positive-sum solutions (Cameron, 2000). Except for the United Kingdom, all these social pacts affected wage bargaining systems, strengthening rather than weakening trade unions.

Realigning Work and Welfare

Contemporary policy fashion emphasizes gainful employment as the axial principle of effective citizenship. The new normative vocabulary of "employability", "life-long learning", "activation", "insertion", "make work pay", and "welfare to work", signals a shift in favor of supply side policies. The new objective is to maximize employment rather than induce labor force exit, and this implies new links between employment policy and social security.

(The Danish activation policies combine successful employment strategies with an extremely generous benefit system. They have been singled out by the European Commission as a "best practice" for others to follow.)

A main priority everywhere is to up-skill workers through either vocational training or education. If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, they can assume the role of a "productive factor". The consensus over life long-learning, however, begins to weaken at the moment one must decide on responsibilities (Crouch et al., 1999). Leaving skill formation to the market may result in under-investment since private firms fear the danger of "poaching" from competitors. Hence, the inclusion of the social partners may be essential.

A more pressing problem is how to ensure training opportunities for those workers who are most likely to become marginalized, such as those in low-skill jobs, part-time or older workers, and immigrants. Improvements in vocational training and education are unlikely, by themselves, to solve the problem of skill deficits, particularly for those who have already entered the workforce. Hence, in the 1990s, several governments experimented with various forms of "activation" programs (Eardley, et al., 1996; Lodemel and Hickey, 2000). The underlying normative philosophy is one of reciprocal obligations: Welfare recipients must be obliged to accept employment or training in order to receive benefits, while the state has the obligation to enhance the employability of benefit claimants.

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

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

Different wage subsidy strategies are appropriate to different welfare states. In the United Kingdom, where income guarantees and unemployment benefits are modest, individual tax credits to support low-wage workers and their families are very popular. In Continental Europe, the main problem is that heavy social contributions price less productive workers out of the market. Hence, reducing fixed labor costs is one way to stimulate jobs. Targeted wage subsidies are seen as a means to spur job growth without, at the same time, accepting American style inequalities.

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

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

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

(The danger is that employment subsidies may lock low-skilled workers into persistent low-wage employment: the erstwhile "inactivity trap" may, in other words, become a "low-skill trap".)

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

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

The reforms discussed above have also triggered institutional change in the ways the promotion of welfare and employment are linked. This is obvious in the case of Danish activation with its individualized guidance and service provision, because it necessitates new institutional connections between social security and employment policy; between the public and private sector. Three trends can be seen :

- the liberalization of public employment service systems;
- the widening scope of coordination between social protection and employment provision; and
- emerging sub-national employment pacts in response to problems associated with regional economic conditions (Ferrera, Hemerijck, and Rhodes, 2000).

Reconciling Work and Family Life

Strategies of labor market de-segmentation are related to the feminization of the labor market. Women now account for the majority of job growth in the European Union but, still, substantial differences in participation rates and also in the nature of female employment remain (Daly, 2000). Low birth rates indicate severe compatibility problems for women across much of Europe, and in Southern Europe especially. Hence the urgent need for policy change.

A first policy priority has to do with childcare, leave arrangements, professional care for the elderly, and the tax treatment of spouses' earnings. More social services like child care, could provide additional employment opportunities, especially for women (Behning and Serrano Pascual, 2001).

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

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

Parental leave arrangements are of critical importance so as to avoid career interruptions. The duration and generosity of entitlements is obviously key. The Nordic countries combine very generous provision and also provide incentives for fathers to participate. In the UK, parental leave is underdeveloped. Indeed, the Thatcher government sought to remove parental leave for fathers from the scope of the EU Parental Leave Directive of 1984. Progress has, however, been made under New Labor. The National Action Plan of 1999 contains an extension of Maternity Allowance to those under the lower earnings limit. In the majority of Continental welfare states there are provisions for either fully or partly paid maternal leave, but additional parental leave schemes are not all that generous, leading to low take-up rates.

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

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

(Pressures for more women-friendly policy are obviously stronger in the Continental European and Anglo-Saxon welfare states with undeveloped leave and care provision. For them, Scandinavia might exemplify a "best practice". However, with the EMU and with fears of tax competition, major public expenditure increases become far more difficult. In light of this, the Dutch part-time strategy may provide an alternative model for others to emulate.)

In Scandinavia, part-time employment has been stagnant and even in decline in recent years. This can be seen as testimony of the highly developed policies for reconciling work and family life; part-time employment is increasingly not *necessary* for working mothers. Especially in the U.K. and the Netherlands, part-time jobs have grown steadily over the past decade and account for a large share of female employment growth. Nonetheless, the regulatory framework remains decisive for whether part-time jobs expand. Their growth in Ireland and the U.K. is in large part the product of labor market deregulation in the 1980s. Here part-time work is mainly a coping strategy among low-skilled and low-paid female workers. The Netherlands exemplifies a more "women-friendly" approach to part-time employment. The Working Hours Act (2000) gives part-timers an explicit right to equal treatment in all areas negotiated by the social partners, such as wages, basic social security, training and education, subsidized care provision, holiday pay and second tier pensions. In the Mediterranean countries, the pervasive absence of part-time jobs means that fewer women are employed, and if employed they are mainly on full-time contracts.

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

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

The Quest for Fair and Sustainable Pensions

Demographic ageing constitutes one of the most pressing policy problems throughout the advanced welfare states. Pressures are greatest for the Continental European countries with their very low birth rates and their high rates of early retirement. The challenge lies in how to allocate the *additional* expenditures that inevitably accompany population ageing.

Ongoing efforts at pension reform offer, once again, an example of path-dependent policy. There are huge sunk costs in whatever system obtains in any country. An overnight shift from pay-as-you-go to a fully funded system would impose a double financial burden on at least one generation. The upshot is that radical change is unlikely, but not that reform is impossible as long as it remains loyal to prevailing principles and starting conditions.

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

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

A variety of measures have been adopted in order to strengthen the actuarial link between contributions and benefits. These include incremental adjustments in the retirement age, replacement rates and indexation systems. Under pressure from EU equality legislation, most countries are in the process of equalizing the legal retirement age of men and women. Increasing the number of years used to define the reference earnings usually leads to reductions in benefit levels. In Finland for example, pension benefits are now calculated on the basis of the last ten (instead of four) years; in Italy, the reference period has been extended to the entire career.

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

In Southern Europe, restrictions have gone hand in hand with attempts to upgrade minimum pension benefits. This, of course, ensures greater intra-generational equality and, institutionally, helps create trade union consent, as evidenced in the Spanish "Toledo Pact".

Both Italy's and Sweden's reforms move in the direction of a defined-contribution pension scheme (Hinrichs, 2001). These are far-reaching reforms, but their implementation is very incremental, allowing for a long transition period which enables younger cohorts to anticipate a decline in prospective pension benefits by building up supplementary private pension entitlements. Radical, though incremental, changes like these are more viable if accompanied by incentives to take up supplementary (private) pension schemes. In addition, the spread of private pension will put pressure on government to enact effective regulation.

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

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

The political feasibility of pension reform depends to large degree on the institutional capacities to orchestrate a consensus among major political parties and/or between the government and the social partners, especially the trade unions (Schludi, 2001). Ground-breaking reforms are almost impossible to achieve without broad partisan support. In Sweden, reform began with a broad political consensus between the social democrats and the bourgeois parties and was subsequently extended to the social partners. In Italy, support from the trade unions was a sine qua non for the shift to a defined-contribution system. Ex negativo, the absence of cooperation among mainstream French parties and the social partners is an important cause for the lack of progress in pension reform (Levy, 2000).

Deepening Social Europe through Open Coordination

Across the European Union we observe a clear convergence of employment and social policy objectives over the past decade. All member states are explicitly dedicated to raise employment, promote social inclusion, invest in the productivity and skills of future workers, and enhance innovation in the pursuit of a competitive knowledge-based economy. The Treaty of the European Union (Title XI, article 136) already lists a number of common social policy ambitions, ranging from "the promotion of high levels of employment, the raising of the standard of living and working conditions, adequate social protection, the social dialogue, the development of human capital and the fight against social exclusion". This convergence in objectives and ambitions not only reflects shared aspirations, but perhaps more precipitously a common concern with the new risks of social polarization which beset the advanced welfare states in the European Union. European citizens increasingly fear a race to the bottom, involving tax competition and/or social dumping between rival economies. Accelerated economic integration without any meaningful social progress could confront the European Union with severe legitimacy problems.

The principal site for welfare reform remains the nation-state and, yet, domestic reforms are severely constrained by the EMU and increasingly shaped by supranational regulation and policy initiatives. While domestic policy makers are wary of surrendering any authority, there is nonetheless a case to be made for greater coordination at the EU-level. Throughout the 1980s, European integration was biased in favor of "market-making", of eliminating trade restrictions and competitive distortions. This clearly inhibited ambitious European-wide "market correcting" employment and social protection policy initiatives (Scharpf, 1997a; 1999). A positive breakthrough was the insertion of an Employment Chapter in the Amsterdam Treaty (1997), stipulating that member states participate in policy coordination around a common strategy defined by the Council. Agreement over the employment title was surely helped along by the rise to power of Center-Left governments in the EU, in particular in large countries, like France, Italy, the UK, and Germany.

The Lisbon Summit marked a watershed in the Europeanization of employment and social policy. It produced concrete commitments to increase the rate of total employment in the European Union to seventy percent (sixty for women) by 2010, the promotion of life-long learning, and increased employment in services. With respect to social protection, it launched the open method of coordination to new policy initiatives for fighting poverty, combating social exclusion, and modernizing systems of social protection. More recently, the Swedish Presidency proposed to apply the method of open coordination to health and elderly care. It also included targets to raise employment among workers aged 55 to 64 to fifty percent by 2010. Hereby pension reform has entered the European agenda, again, in large part as spillover from EMU and the Stability and Growth Pact. The Belgian Presidency in 2001 forged a political agreement on quantitative indicators for monitoring progress with respect to soc ial inclusion across member states. It also sponsored, at the Laken Council in December 2001, common objectives for pension reform. The fight against unemployment and social exclusion has thus become part of the EU constitution.

(OMC exemplifies a "contextualized" method of benchmarking, allowing consultation over guidelines and national action plans, with ongoing feedback on implementation. This in sharp contrast to the one-size-fits-all that often characterizes OECD and IMF recommendations.)

With fifteen different welfare states, not to forget a possible enlargement with ten candidate countries, there obviously does not exist any single "European social model" towards which member states of the European Union could possibly converge in the next decades. Clearly, the issue is not one of subordinating domestic policy to EU directives but rather one of joint policy learning and cooperation. With the launch of the European Employment Strategy a new model of cross-national policy making through monitoring and benchmarking was inaugurated: the so-called Open Method of Co-ordination (OMC). OMC is a procedure whereby domestic policy actors respect national differences while accepting commonly agreed guidelines and taking inspiration from "best practices" abroad. The objective is not per se to achieve common policies, but rather to share policy experiences and practices. Policy choices remain at the national level, but are no longer pursued in isolation. Specific policy problems are defined as common concerns, and government agree to have them compared and evaluated in organized iterative processes. Clear and mutually agreed objectives are defined, which enable member states to examine and learn from the best practices in Europe through peer review, organized by the European Commission. Not shared ontological aspirations, but rather common objectives in terms of prudent policy concerns, are essential. These then allow policy makers to translate the much discussed but underspecified "European social model" into a set of agreed policy objectives. This procedure potentially goes well beyond the "usual solemn but vague declarations at European Summits" (Vandenbroucke, 2002).

OMC exemplifies a "contextualized" method of benchmarking, allowing consultation over guidelines and national action plans, with ongoing feedback on implementation. This in sharp contrast to the one-size-fits-all that often characterizes OECD and IMF recommendations. OMC helps de-politicize the issues at stake. In addition, it facilitates policy in areas where EU competencies are relatively weak, where regulation is infeasible and impracticable. Open coordination has the potential to develop into a valuable addition to the modes of governing now available in the European polity. It is imminently more flexible than joint-decision procedures or inter-governmental negotiations. Moreover, in contrast to mutual adjustment, it can provide useful safeguards against an unintended "race to the bottom" (Scharpf, 2000b). Successes achieved through OMC are likely to enhance the legitimacy of the EU as a social union.

Nonetheless, OMC is fragile in the sense that it is highly contingent on the extent to which national policy makers see themselves as pursuing convergent or parallel goals. Some also fear that "soft" policy coordination, with its lack of real sanctions, will crowd out "hard" legislation. Moreover, rushing towards social benchmarking with reference to vague objectives runs the risk of discrediting the entire process. In the absence of sanctions or rewards, the attempt to coordinate social objectives may prove futile. A final concern is how much diversity in welfare design, institutional structure, and problem loads OMC can tolerate. This issue may become acute with the impending accession of many Central and Eastern European countries.

Conclusion: the Contingencies of Policy Innovation

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

It is striking how many domestic reforms have been enacted in the past decade and how little they followed the textbook neo-liberal prescriptions. Nonetheless, recent EU initiatives have all been couched in terms of the idea of "social protection as a productive factor". Looking back on past policy experience, one can easily detect a significant shift from a normative to a cognitive discourse in legitimizing the welfare state, from a social justice and decommodification perspective, bent on modifying and correcting the operation of the market system, to one of emphasizing the productive double bind between social cohesion and economic competitiveness.

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

Domestic vulnerabilities and policy innovation at the national level have, in turn, shaped the employment and social policy agenda of the European Union. Persistently high unemployment in the run-up to the EMU raised the urgency of a common European strategy. In the second half of the 1990s, aided by the presence of Center-Left governments, we see a deepening of Social Europe. The success of the European Employment Strategy catapulted the open method of co-ordination. OMC may very well unleash a process of "hybridization" in welfare and labor market policy. This could lead to new policy mixes, something which is already apparent in small countries like Denmark, Ireland, the Netherlands, and Portugal.

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