Globalization and European Welfare:
Is there a ‘Third Way’ for the Public Domain?

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Martin Rhodes

‘Globalization’ is a buzzword but one reflecting an important if as yet poorly understood reality. A ‘new international division of labour’ has emerged, with extensive and expanding trading networks between countries, as well as new production networks (or ‘chains’) established by transnational companies (MNCs). Tariffs have declined to negligible levels among the industrialized countries and successive GATT negotiation rounds have increased the openness to trade of the developing countries as well. Meanwhile, the latter have become major exporters of manufacturing goods. Their share of world manufacturing output grew from 5 per cent in 1953 to 20 per cent in 1994. The world trade-GDP ratio has doubled to around 15-20 per cent since the 1950s, and the emergence of global markets has been accompanied by the growth of global production and intra-industry trade. Currency transactions, meanwhile, doubled between 1989 and 1992 – to $1.2 trillion per day – a figure much larger than the currency reserves of the world’s central banks (Garrett 1998a: 790).

As a result of these and associated developments, it has been argued that the role of the nation-state in the international system has been fundamentally transformed. The ‘old’ social contract - and its diverse institutionalization in Europe welfare states - was very much part of the ‘golden age, during which there was a coincidence of national sovereignty (preserved with the help of exchange and trade controls), uninterrupted growth, and the Keynesian welfare state (Ruggie 1982). In the new ‘global era’ it is argued that the state no longer has the capacity for defending competitiveness within economic borders or for sustaining national social contracts and workers’ rights and entitlements. For those who accept that globalization is far from complete, the real culprit in constraining European social policy and welfare options is European integration, not just as a vector of globalization, but as the source of regulatory competition among the member states. National governments in the past could set taxes, establish labour regulations and influence the framework for corporate governance. But an integrated European economy makes it relatively easy, it is argued, for companies to circumvent national jurisdictions. By shifting production abroad, moving their tax burden round the world and transferring their corporate entities to other stock exchanges, they can thereby undermine the power of governments. The consequences for employment and labour market regulation may be profound: international and intra-European competition are fragmenting labour markets, upsetting the traditional balance of power between capital and labour and demanding a far-reaching transformation of the conditions of employment if high levels of unemployment are to be reduced. For many neo-liberals (and social democratic pessimists), these developments signal the death of the European ‘social model’ based on longstanding commitments to low levels of inequality, solidaristic welfare policies and protective systems of labour market regulation – and, in many countries, the demise of the social partnerships that underpinned them.
This article maintains that this argument is mistaken in a number of ways. It exaggerates the extent of globalization and its impact on the European economies and ignores the importance of domestically generated challenges to the institutional status quo. Furthermore, arguments that European economies are undergoing reorganization along neo-liberal lines under-estimate the capacity of their institutional arrangements and public domains for adapting and responding to internal and external pressures for adjustment. In particular, they ignore widespread evidence that the organized capitalist economies of Europe are already engaged in the search for new solutions that preserve commitments to solidarity and high levels of labour market regulation while also seeking to make welfare states more efficient and employment systems more flexible. The public domain is therefore being reconfigured rather than destroyed. Public goods in the form of political and social consensus, high levels of social security cover, extensive labour market regulation and a commitment to core welfare programmes remain as central to the success of these economies as in the past – albeit with a more ‘competitive’ orientation. Nor is there any real evidence that countries with institutionalized social partnerships are abandoning them in favour of unilateral state or employer decision making. Meanwhile, those countries where social partnership or corporatism have been non-existent or weak are strengthening or putting such mechanisms for social consensus creation in place. This is not to argue that European countries are converging on a new domestic institutional equilibrium or that their welfare state and employment problems will thereby be solved. But if there is a European ‘Third Way’ at the dawn of the 21st Century, it is this: an elaborate social, economic and institutional compromise between states and markets in which capitalism is liberalized but not unbound (Rhodes and van Apeldoorn 1998b).

Part one of this article explores the scope for such an enterprise amongst the multiple pressures allegedly exerted by globalization. Part two, which introduces the notion of ‘competitive corporatism’, argues that institutions for negotiated adjustment remain resilient and can assist in producing policies that aim to reconcile social justice and growth.

1. The Challenge of Globalization: Myth or Reality?

Supporters of what we can call the ‘strong globalization’ thesis point out that, while observable relationships may not have changed very much, and while the nation-state clearly remains important, something clearly has changed. Support for strong welfare states seems to have declined (certainly among élites if not among publics) while not only have cutbacks in social provision and the liberalization of labour markets taken place in many countries but they are often justified in similar market-supporting terms. Furthermore, they would argue, the era of egalitarian and redistributive policies is clearly over. For the traditional project of the post-war Left now faces considerable obstacles, given the uncontainable power of global financial markets, the veto threat of multinational companies and the emergence of a transnational neo-liberal consensus, backed by MNCs and international organizations such as the OECD, IMF and World Bank. Even if union membership
remains high in certain countries, and social democratic parties are in power, this does not mean that the social democratic ‘project’ can move forward or that the neo-liberal onslaught can be halted.

In response, a ‘globalization sceptic’ would reply that many of the difficulties national-policy makers have experienced with macroeconomic management - balancing budgets, mobilizing sufficient revenue to fund programmes and so on - have more to do with internal fiscal difficulties caused by recession than ‘globalization’ tendencies. Prolonged economic recession coupled with demographic changes have required governments to raise more taxes to support the increasing number of jobless and citizens retiring from productive work. These pressures on the public purse are occurring at a time of stagnant living standards (Weiss 1997: 14). Pierson (1997) would add that welfare states have generated many of their own difficulties. By helping improve living standards and life spans they have created new social needs that social services were not originally designed to meet. Meanwhile, other problems stem from the increasingly post-industrial nature of many advanced societies. As Rowthorn and Ramaswamy (1997) point out, this trend has little to do with trade but much to do with the natural maturation of industrial economies.

Nevertheless, as in all academic debates, there is a middle ground to be found between the extremes. For this reason it is worth taking the globalization arguments seriously while also ranging against them the appropriate counter-claims. The principal arguments concerning the impact (existing or potential) on European welfare states and labour markets are trade and competition, the globalization of finance, tax competition, and the role of multinational companies. We briefly survey these arguments below prior to deciding what is and is not important for understanding contemporary European developments.

**Trade and Competition**

For every gloomy thesis there is an optimistic counterpoint. Free-trade optimists argue that trade integration with the South leads to efficiency gains as it releases workers in the North from low-productivity sectors where its firms can no longer compete. Rising imports of labour-intensive manufactures from the South may hurt workers in contracting sectors, but this problem is seen as localized and temporary, and can easily be dealt with by making labour markets more flexible. Imports to the North provide the South with the foreign exchange to pay for more sophisticated northern exports, also raising employment in the northern high-productivity sector. In sum, as a result of trade integration, employment in the North will shift from low to high-productivity sectors, improving overall efficiency and aggregate welfare. If the optimists are right, there should be no long-term adjustment costs for advanced country labour markets.

The pessimists disagree. Wood (1994; 1995) argues that as skilled labour is relatively abundant in the North and unskilled labour abundant in the South, the latter will tend to specialize in the production (and exportation) of unskilled, labour-intensive products, while the North will specialize in skill-intensive items, exporting them to the South. Thus, as trade integration proceeds, the relative demand for unskilled labour in the North will fall, leading to either lower wages (where wages are
flexible, as in the US) or higher unemployment (where they are rigid, as in Europe). The evidence is that in Europe the rising unemployment rate has been accompanied by a rising vacancy rate; unemployment is concentrated amongst unskilled or low-skilled workers; and thus unemployment seems to be caused at least in part by a rising skills mismatch.

This argument has not gone unchallenged (e.g., Sachs and Schatz 1994; Burtless 1995). One of the most influential counter-arguments concerns the nature of the global market for labour. As Freeman (1995) argues, the notion that trade with the South is responsible for growing wage inequality and unemployment in the North not only assumes equal access to technology - so that trade is determined solely by factor endowments - but also a fully integrated, single global labour market in which demand and supply set the price of all labour. In fact, labour is not homogeneous: better qualifications command a return to human capital and protect many workers in industrialized countries from lower pay. The way capital is used also protects workers against levelling down: better infrastructure, including communications and R&D all raise returns to labour. Specialization in the production of different goods among traditional countries and their new trading partners reduces downward wage pressures in the former (see Thygesen, Kosai and Lawrence 1996).

There is also an argument that trade is much less important than technological change in producing a pervasive shift in labour demand from lower to more highly skilled workers (Slaughter and Swagel 1997). For while there may be an interaction between globalization and technological bias, the bias in technological progress towards the skilled predates the globalization of the last decade or so.

Does this mean that we can discount the trade and competitiveness argument? Not entirely, for it is inconceivable that trade competition is unconnected to technological change or that, in combination, they have few implications for labour markets, employment and social policy. Snower (1997) links trade competition, skill-biased technological change and ‘the organizational revolution’ in explaining problems in sustaining the welfare status quo, greater wage dispersion and rising unemployment in the industrialized countries. Four developments are seen as crucial: the reorganization of firms into flatter hierarchies; flexible, computerized manufacturing, allowing production decentralization and the adoption of ‘lean’ and ‘just-in-time’ methods; dramatic changes in the nature of products and in seller-customer relations; and the breakdown of traditional distinctions between ‘skilled’ and ‘unskilled’ workers as employees are given multiple responsibilities. By making existing jobs less secure, and making traditional skills – and those who possess them – redundant, these developments are likely to create greater reliance on unemployment insurance, public support for education and training and a wide variety of welfare state services. This may generate what Snower calls ‘the quicksand effect’ - the phenomenon whereby welfare structures designed for a different era become weighed down and generate negative effects, destroying incentives and making redistributive policies inefficient, while the productivity of welfare services declines and their cost increases.

This argument, if correct, gets around the frequently made objection to the trade competition thesis that only around 14 per cent of European trade is with the rest of the world and is therefore relatively unimportant. For such trends could also be driven by increases in intra-European trade (now
at 70 per cent of Europe’s total, compared with only 9 per cent with Asia) (Fligstein 1998). But what are the policy implications for the public domain? As for welfare structures, many countries are now engaged in policy innovations to reduce the ‘quicksand’ effect of social policy provisions by tackling the costs of transfer-heavy welfare states and redesigning benefit formulas so as to make them both financially sustainable and more employment friendly. As for employment, the outright deregulation of labour markets is clearly not the answer (a topic we return to below). For while a moderate degree of wage flexibility might help contain the high rates of unemployment in Europe, the main emphasis has to be on the unskilled or those whose skills are becoming redundant. As Scharpf (1997; 1999) argues, the big employment shortfall in many parts of Europe is in the services sector and especially personal services that use much less skilled labour and where tax wedges may deter new recruitment. Upgrading the skills of the workforce, and hence gradually shifting the relative supply of skilled and less-skilled labour, is also important. One way to do this is to change the relative price of skilled versus unskilled labour by greater wage differentiation, while avoiding greater inequality by engineering changes in tax and transfer systems. Another is to lower high indirect labour costs differentially, so that these costs are reduced most sharply for the lowest paid and then phased in gradually for those earning more. As argued below, this is precisely the type of reform that many European countries are now engaged in, requiring complex trade-offs and a negotiated approach to adjustment.

The Globalization of Finance

For many, the globalization of financial markets is the main culprit in explaining the reduced autonomy of national governments and their inability to respond in progressive ways to new social policy and employment challenges. Many analyses of economic policy autonomy depart from the so-called Mundell-Fleming theorem or the ‘unholy trinity’ which states that exchange rate stability, capital mobility and domestic monetary independence cannot be achieved simultaneously (Andrews 1994; see also Webb 1991, Frieden 1991, Goodman and Pauly 1993 and Perraton et.al. 1997). The argument is that in the 1960s - when capital mobility was still limited - payments imbalances arising out of divergent macro-economic policies were still small enough to be manageable. Now that capital is internationally mobile, this is no longer so: external positions can only be stabilized by co-ordinating the aforementioned policies themselves. If capital is highly mobile across borders, then some policies will be rewarded while others will be punished. Thus, if a deficit country decides to pursue an expansionary monetary policy relative to other countries, it will experience pressure either to devalue or to defend its currency (depleting its foreign exchange reserves) (Andrews 1994). The main implication for social policy and employment is that in an environment of international austerity, it becomes increasingly costly for individual states to pursue an expansionary monetary policy as part of an effort to stimulate growth and employment (Eatwell 1995).
A second argument concerns the shifting balance of power. Now that capital controls have been lifted, new and privileged interests have been embedded in the policy-making process to the extent that re-instating them has become very difficult. Meanwhile, new coalitions have been formed ‘revolving around the differential effects of greater openness’, a reaction in part to the changing opportunity costs created by the benefits of participation in the international economy (Keohane and Milner 1996a). Frieden (1991) argues that because capital mobility has given investors a wider set of choices, governments are forced to provide more favourable conditions to capitalists. Increased financial integration has increased the social and political power of capital – in particular capitalists with mobile or diversified assets [such as multinational companies - MNCs] - and disfavours those with assets tied to specific locations and activities such as manufacturing.

Those most affected by such developments are purportedly left or social democratic governments devoted to policies to bolster employment growth and defend welfare spending. A regression analysis of the interactive effects of economic internationalization and left-labour power on economic policies for fifteen OECD countries carried out by Garrett (1995; 1998b) concludes that the ‘propensity to deficit-spend’ - which he calls ‘the political-economic sine qua non of social democracy’ - has not been constrained by increasing trade and capital mobility but rather strengthened with greater internationalization. On the other hand, he also points out that the integration of financial markets has put a premium on left-wing policies in terms of higher interest rates, something that in the future might still pose problems for social-democracy. As Keohane and Milner (1996b) also suggest, there is evidence that financial market integration or capital mobility has potentially a much more detrimental effect on the policy-making autonomy of Left-Labour governments than trade integration.

All of this might suggest that the game is up for countries wishing to defend or reinforce social solidarity in the public domain in an era of global finance. But as Glyn (1995) has argued, the real issue here is ‘credibility’ with the markets. Globalization has often simply been made the scapegoat for the failure of certain nation states (Britain in the 1970s, France in the early 1980s, Scandinavia in the early 1990s) to control their domestic sources of social conflict and spending – an argument also applied to the Scandinavian social democracies by Notermans (1993). After all, if budgetary capacity and price stability permits it, there is no reason why increases in welfare spending or equitable modifications to the welfare status quo should be penalized and retrenchment rewarded. The real task is to build or rebuild domestic coalitions and arrangements containing trade-offs that make such policies ‘credible’ with the markets (as well as with national capital). Again, as argued below, although not easy, this is precisely the path being taken by many European countries.

**Tax Competition**

Tax competition should also be taken seriously as a challenge to the traditional public domain for obvious reasons, although again not necessarily as an ineluctable force making national governments impotent. Tanzi (1996) and Rodrik (1997) - among others – have argued that governments can no
longer maintain let alone expand their generous welfare state-progressive taxation mix due to increasing tax competition, and that the future of the welfare state requires shifting the tax burden from mobile (firms and financiers) to immobile (labour) asset holders, thereby emasculating its redistributive effects. Globalization thus induces a process of ‘tax degradation’ - and a tendential ‘race to the bottom’ - by enabling individuals and especially firms to exploit the existing differences between national tax systems.

Could this be the principal mechanism eroding systems of social and income protection? Research (e.g. Swank 1992) has shown that between the 1960s and mid-1980s, those economies most exposed to international markets exhibited a tendency (conditioned by partisan control of government and party policy preferences) to respond to ebbs in investment policies with reductions in levels of corporate taxation. Left-wing governments seemed the most sensitive, especially with regard to investment in new productive capacity. One explanation for this is that left-wing governments need to compensate for the negative effects (on the investment climate) of their other policies, e.g., an extensive social security system, redistributive policies and labour market regulation. Thus social democratic governments may be caught in a contradiction: in trying to boost employment creating investment they must also shift the tax structure to the disadvantage of immobile employees.

More recently, however, Swank (1998) and others have argued against the claim that increasing international capital mobility has generated a shift away from capital taxation, and that governments have continued to rely on corporate taxes for a significant, and even in some cases, a growing, share of revenue. The considerable changes that have occurred in the structure and rates of taxation have coincided with attempts to make to make the overall changes revenue neutral or otherwise protect the revenue needs of the state. Thus, rate cuts have been offset by broadening the tax base and the elimination of investment-related allowances, credits and exemptions (Swank 1998: 678-79).

Nevertheless, the implications for policy are arguably still important. Clayton and Pontusson (1997) argue that whatever the direct distributive consequences of falling rates of corporate tax, they make life harder for social democratic governments by reducing the scope of using the tax code to boost investment and employment. Thus, income taxes have become less progressive, corporate tax rates have fallen, and the burden of taxation has tended to shift toward indirect taxes such as VAT. With the flattening of corporate tax schedules, governments have reduced their ability to influence the volume or character of private sector investment in line with egalitarian policy objectives. For as Ganghof and Genschel (1999) argue, while revenues from capital income taxation may not have fallen, on average, they have also not increased. This contributed to the fact that the average total tax ratio of the 18 most advanced (and largest) OECD countries has stagnated since the mid-1980s and has not kept up with increasing public expenditures. Tax competition is not the main cause of the financing problems of the welfare state. But it clearly has constrained policy responses by making some forms of revenue-raising more costly at a time when the maturation of welfare programmes (see below) has increased spending.

One solution in the face of greater capital mobility might be to tax more heavily spending with an unavoidable physical presence, namely property (The Economist 1997). Another - perhaps the
most popular alternative - would be to shift the burden to consumption, including levies on energy use, pollution and other ‘green’ taxes. But as Scharpf (1997) argues, this would be regressive and also destructive of low-productivity service employment. There is thus a considerable need to rethink a range of fiscal policies and their relationship with social security expenditure. In Daniel Draches’s terms, the state in the era of market-driven globalization may be no smaller and indeed larger than in the past, but it also needs to be ‘smarter’. Again, this is inimical neither to negotiated paths of adjustment nor an equitable recasting of welfare states – and may indeed depend on them to enhance institutional capacity. Labour market reform and responding to high levels of unemployment requires simultaneous changes to social security, tax and pensions systems: and where it is logical to negotiate these reforms through corporatist-style bargaining, this is now being done. We return to this point below.

**The Power of Multinationals**

What of workers’ rights and entitlements? The strong globalization thesis argues that these are being driven down by regulatory competition, as transnational companies shift production abroad and pitch the lower labour costs and wages of developing country workers against their better paid industrialized country counterparts. But while there is evidence that some MNCs shift production to take advantage of lower labour and other social costs, this argument underestimates the complexity of MNC strategies and overestimates the footloose nature of these companies and their production process. In fact, the idea that there has been a massive shift to low cost locations is not borne out by statistics. Weiss (1997:10) presents convincing evidence that MNCs do not by and large invest where wages and taxes are lowest: between 1967 and 1991, the total of world stock of FDI located in high-wage and relatively high-tax countries increased by 12 points to 81 per cent. Moreover, as Ruigrok and Tulder (1995) convincingly demonstrate in a study of the internationalization strategies of the world’s one hundred largest companies, not one of these can be dubbed truly ‘global’, ‘footloose’ or ‘borderless’. In addition, ‘domestic bargaining arenas in all parts of the world impose huge social, political and financial constraints, thus setting the outer margins of a core firm’s internationalization strategy’. As argued by Pauly and Reich (1997: 24ff), as key actors in the development and diffusion of new technologies, the ‘national rootedness’ of MNCs remains a vital determinant of where future innovation takes place. The power of MNCs to ‘arbitrage’ diverse national structures and force deep, structural convergence across diverse societies is, they argue, ‘chimerical’.

Nevertheless, even if it does not relocate all parts of its production and design process, the internationalized firm can use the threat of exit to modify contractual relations in the labour market, with important implications for employment and, indirectly, social policy. German firms, for example, have increasingly used locational threats to weaken the power of unions and force concession bargaining (Mueller 1996). As a result, German companies and unions are now agreeing patterns of flexible working that were unthinkable just five years ago, and many of these are reached locally with
company works’ councils, thereby circumventing national accords. But the national union, IG Metall is also sometimes involved and most of the deals reached modify only marginally the status quo. Further reaching changes might be expected in countries such as Ireland where foreign (mainly American) companies accounted in 1996 for 47 per cent of manufacturing employment, 66 per cent of the sector’s gross and 77 per cent of its net output and 84 per cent of industrial exports (OECD 1999: 54). Nevertheless, multinationals in Ireland have by and large complied with that country’s industrial relations rules and have not sought to counter the advances made under its various social pacts, including most recently (May 1999) an agreement between unions and employers to counter a growing trend for union derecognition.

In the end, the role of domestic institutions and actors will be critical in conditioning not just the embeddedness of the MNC in its home base, but also its strategies of foreign direct investment and the relations it forms in new production locations - including relations with workers and unions. The critical point here is that, as Lange and Scruggs (1997) show, a strong union context is unlikely to be undermined by FDI, although MNC investment will clearly not assist in building a strong union culture or organizational base where it does not already exist. Not only do open economies seem able to sustain strongly unionized environments, but corporatist bargaining structures remain strong in those economies increasingly exposed to international forces by growing international economic integration. As shown by the persistence of centralized or co-ordinated bargaining in Scandinavia (Wallerstein and Golden 1997), and by the emergence and consolidation of new forms of social partnership elsewhere in Europe (Rhodes 1998a), internationalization may well have the opposite effect to that which is generally assumed. Far from disaggregating organized interests and allowing business to break free from constraining policy arrangements, it seems in many instances to be reinforcing them. The institutional networks underpinning the public domain in European social and employment systems may be changing but they are not necessarily weakening.


The discussion to this point has tried to put the globalization arguments in perspective. We can sympathize with Pierson (1997) when he writes that ‘although it is important to recognize the linkages between international and domestic developments […] such links are likely to be more modest, complex and bi-directional than is commonly suggested’. However, as argued above, these links do exist. Together, trade competition, the liberalisation of exchange control and internationalization of financial market, tax competition and the power of multinationals may be reducing the autonomy of the state, changing the balance of power between capital and labour, and making welfare politics more problematic. The public domain is clearly therefore a more contested place in the contemporary period than in the ‘Golden Age’ of welfare (although one should not thereby underestimate the degree of contestation that has always characterized it). Traditional – and hitherto rather stable - national bargains on welfare and labour market regulation are therefore under
stress. But the influence of these factors has to be considered in conjunction with domestic sources of strain and within the context of national institutions that continue to filter external pressures for change.

Internal Pressure and the ‘New Politics’ of Welfare and Employment

Although apparently ‘in crisis’ due to the combination of factors mentioned above, welfare states have actually changed very little in recent years – at least in terms of their broad objectives and spending levels. The state in this respect has continued to expand. According to an OECD investigation of 15 cases of fiscal consolidation involving 11 countries, in all but one (Ireland 1986–1989), governments pursuing consolidation increased revenues as a percentage of GDP and in nine of the 15 cases, revenue increases accounted for the majority of fiscal consolidation. Transfer spending fell in only seven cases, and generally by very modest amounts. Only three of 15 cases reduced transfer spending by more than one per cent of GDP while six achieved that large a cut in public consumption, and seven in investment spending (Pierson 1997; OECD 1996). In fact, to date, there is little sign of a major onslaught on European welfare states, except for Britain under the Thatcher/Major governments. Support for the welfare state remains high amongst publics everywhere and institutional stickiness creates tremendous resilience against pressures for change. The most important changes in Europe have been increased managerialism (in line with a new and spreading orthodoxy of public sector management); attempts to make certain benefits (especially unemployment support) more ‘incentive compatible’; a marginal degree of privatization (mainly in health, and mainly in Britain), some decentralization; and attempts (largely successful) to control budgetary expansion (see Therborn 1997 for a survey).

This hardly amounts to ‘neo-liberal’ convergence. As far as the scale of welfare expenditure (public spending as a proportion of GDP) is concerned, the pattern across continental Europe still largely conforms with Esping-Andersen’s (1996) image of a ‘frozen landscape’. However, in institutional terms, governments have been introducing changes within their systems to deal with perceived cost pressures by experimenting with finance, the organization of provision and access to benefits. While this has not undermined the core of the major programmes for social protection, important changes are now occurring, in many cases as the result of complex new bargains.

A recasting of the traditional welfare bargains of Europe is essential, for the ‘frozen landscape’ metaphor indicates sclerosis rather than a stable and sustainable equilibrium. Pierson (1998) has construed the crux of the problem in terms of ‘irresistible forces’ (post-industrial pressures) meeting ‘immovable objects’ (strong public support and veto points). Thus, the relative growth of the service sector implies lower productivity growth and entails either greater public spending or increased wage inequality if new jobs are to be created. The maturation of governmental commitments and population ageing demand reforms to health care provision and old age pensions (in 1992 these accounted for 80 per cent of all social protection outlays in the European Union) if costs are not to escalate and employment creation stymied by higher direct taxation and/or payroll
Then there is the unemployment problem itself. The task of responding to persistent high rates of unemployment across the European continent (compared with high rates of job creation in the liberal welfare states of the UK and USA) reveals how different national systems have to face the sometimes-adverse consequences of existing social contracts. In the past, each ‘welfare regime’ has created its own employment pathology. In Scandinavian countries, the distributional costs of generous social contracts were met by those in employment who have paid high taxes for an over-developed public sector to soak up the potentially unemployed. In continental Europe, governments, employers and labour unions have more or less agreed that the price of adjustment should be shouldered by the unemployed, comprised largely of younger, female and older workers. In southern Europe, an acute ‘inside-outsider’ problem has developed as a result of the fragmentation and disparities in the income support system for those without work, with large differences in the level of protection given to core and marginal workers. All three continental regimes are haunted by the spectre of ‘the service sector trilemma’ (Iversen and Wren 1998) in which the goals of employment growth, wage equality and budgetary constraint come increasingly into conflict (see also Esping-Andersen 1996 and Scharpf 1997; 1999). If service sector employment is to be generated in the private sector, this entails adjustments to wage and non-wage costs for the less skilled and greater wage inequality. Creating such employment through the public sector (the traditional Scandinavian solution) entails increased budgetary pressure at a time when deficits and higher taxes are definitely out of fashion. The alternative to doing neither would appear to be continuing if not rising unemployment.

The severity of Europe’s unemployment problem is producing a consensus that part of the solution will come from changes to the regulations that cover both employment and the funding of welfare. If income inequalities are not also to increase, such changes must be accompanied by other innovations such as work-sharing and reforms to taxation (e.g. the introduction of negative income taxes) alongside a regulation of the sheltered sectors of continental economies, to price people with low or non-existent skills into work. But electoral incentives, ‘institutional stickiness’ and the veto points created by powerful vested interests devoted to defending transfer-heavy welfare states and their redistributive outcomes make anything other than incremental reform very difficult. As Pierson (1998: 556) puts it, the ‘new’ politics of the welfare state ‘involves a complex two-level game, incorporating both an electoral arena and a corporatist arena’. Reforms to health care systems, pensions and labour markets all require a careful process of adjustment if social cohesion as a governing principle of these systems is not to be sacrificed and if core constituencies and their representatives (welfare professions, the labour movement, citizens) are not to erect insuperable impediments to change. Thus, once again, these large states have to become ‘smarter’ and concertation is one way of enhancing their institutional capacities. However, advocates of the globalization thesis would argue that the disorganizing effects of greater competition, post-Fordism, porous economic borders and the enhanced power of capital make such consensus-based solutions impossible. Are they correct?
The Scope for Negotiated Adjustment

As shown by recent experiences, potential blockages in the process of reform are being avoided in some countries by the creation of new coalitions behind the reform agenda, most notably through new types of concertation and negotiation. Indeed, one of the most important, but until recently largely neglected, aspects of the new politics of welfare in Western Europe concerns the transition in some countries towards new nationally-negotiated social pacts. These were referred to in a previous article as ‘competitive corporatism’ (Rhodes 1998a) to distinguish them from traditional forms of social corporatism and to signal their competitive rationale. Those which have attracted most attention are those in Ireland, the Netherlands, Portugal and Italy although others can be identified in Scandinavia (albeit against the background of a more institutionalized corporatist tradition) while still others appear to be emerging in more hostile political environments (Spain).

According to much analysis of state capacity and the potential for coalition building in contemporary Europe, such innovative forms of corporatism should not be possible. Grahl and Teague (1997: 418) argued that ‘... there is no reason to doubt that, as a strategic programme for the resolution of employment issues, neo-corporatism is moribund - defeated on the ground by the actual evolution of employment relations before reluctant abandonment by its academic proponents’. Lash and Urry (1987) put forward a persuasive thesis concerning the decomposition of traditional institutions in the transition to post-Fordism, and their recomposition on a more flexible, decentralized basis. Streeck and Schmitter (1991) argued that a combination of the business cycle effect and European integration would remove the logic that had underpinned successful corporatism. An integrated European economy, with less room for discretionary national macro-economic policies, would reduce the incentives for unions to organize collectively and deliver wage restraint in return for package deals or side payments. Gobeyn (1993: 20) argued that ‘contemporary economic realities […] make corporatism largely unnecessary. Market forces alone can presently achieve labour discipline and wage demand moderation’. In-depth analyses of the experiences of particular countries apparently confirmed the unidirectional nature of such developments and the role and responsibility of globalization behind them. Thus, Kurzer concluded her 1993 study of Belgium, Austria, Sweden and the Netherlands by stating that social concertation was no longer feasible: ‘high capital mobility and deepening financial, integration prompt governments to remove or alter institutions and practices objectionable to business and finance’ (Kurzer 1993: 244-245). It is also argued (and not just by right-wing economists) that the labour market rules and welfare state organization linked to such concertation have now become dysfunctional for growth; and that institutions that underpin them are in the grip of such deep uncertainty that the importation of the UK’s neo-liberal deregulation policies to the rest of Europe should not be discounted (see Grahl and Teague 1997; Teague and Grahl 1998).

Much of this type of argument flies fully in the face of the evidence. The fact of the matter is that, at the dawn of the 21st Century, all of the countries referred to by Kurzer – plus many of their neighbours - retain critical elements of policy concertation between capital, labour and the state and/or various degrees of centralized or co-ordinated wage bargaining. This tendency to exaggerate
and extrapolate the crisis and collapse of corporatism is due in part to the ‘Swedish syndrome’. Just as Sweden was long seen as the example par excellence of the corporatist welfare state, so more recently it has been considered a harbinger of things to come. For the collapse of Swedish centralized wage bargaining in the 1980s suggested the imminent demise of a ‘model’ combining a strong, decommodifying welfare state with low levels of income dispersion. If Sweden could not survive globalization and the increased services orientation of the economy, then which country could?

In fact, corporatism is alive and well and living in some unsuspected places. But why should this be the case, given that - at least until recently - even the ‘high priest’ of corporatism, Philippe Schmitter (1989) was convinced of its imminent demise? There are a number of reasons. First, arguments predicting a widespread transformation of the European economies were simplistic and ignored three essential limits on radical change in both policies and institutions in continental Europe: path dependence, the prevailing distribution of organizational power and the ‘efficiency’ deriving from the established links between competitiveness, systems of macro-economic regulation and the microstructures of industries and firms (see Gourevitch 1996). Path dependence and resistance to change derive from the fact that forms of labour market regulation are deeply embedded in national systems of law and collective bargaining. The fact that the existing distribution of power in continental systems (with the exception of France) is located in the sustained strength of both employers’ and trade union organizations, often organizationally linked to political parties in coalition governments, clearly limits and conditions the scope and content of reform and socioeconomic transformation.

Second, far from being a ‘fair weather’ creature, as many had argued, corporatism has really come into its own during the recent years of recession and high levels of unemployment. This suggests that the ‘business cycle’ theory of corporatism (reiterated in Schmitter and Grote 1997) is flawed. The truth is that many of the factors that were supposed to topple the corporatist edifice have in fact supported it. A fragmentation of interest associations has occurred in some cases as socio-economic change and restructuring has undermined traditional memberships. There have also been attempts to decentralize systems of wage bargaining, or differentiate from national pay norms at lower levels. But generally, unions and employers in continental Europe have acted to prevent these developments from endangering either national bargains or the institutional structures that underpin them. Employers’ organizations and trade unions are both aware of the costs involved in the outright loss of public goods such as pay co-ordination and the dangers of free riding. For decentralised systems are notoriously prone to wage drift and inflation - which can only be countered by a rising level of unemployment - and international competition makes unit wage cost containment an imperative (Rhodes 1998a; 1998b).

Nor, contrary to expectations, has flexible specialization seriously threatened corporatist arrangements or collaborative industrial relations: first because its extent has been exaggerated and second because where it has been implemented it has actually increased the need for co-operative labour relations and the collective provision of vocational skills. As Negrelli (1997) notes in the Italian case and elsewhere, modern human resources management can be combined with traditional industrial relations practices, creating possibilities for mutual enrichment between these two different
systems for organising the workplace. This complementarity derives from the beneficial trade-off between job security and flexibility at work, producing positive effects for industrial adjustment. It is also wrong to assume that employers have uniformly attempted to use restructuring to weaken trade unions: although this has certainly been the case in Britain, industrial relations remain distinctively consensual in countries with a tradition of social partnership. Despite its difficulties, German Mitbestimmung, for example, retains its functional value. As in the case of pay bargaining, it is not so much that employers are constrained by unions to participate in these arrangements, but that they are generally aware of the great sense in doing so in terms of their own interests. For as Thelen (1998) argues, most German employers are acutely aware of the costs to themselves of a decentralization strategy that seeks a radical shift in the balance of power with labour. For similar reasons, other countries – to be discussed below - which seek to follow a ‘high road’ (i.e., high wage/high productivity path) of economic adjustment may consciously seek to develop similar co-ordinating capacities in their own economies.

As for economic performance, continental systems retain enormous economic strength and their large and successful export sectors and trade surpluses demonstrate that their regulatory systems - including their labour market rules - are far from dysfunctional, at least for their traditional growth paths. Moreover, there is considerable empirical evidence for a strong and positive correlation between such ‘co-operative economies’ and high rates of productivity and investment growth, whereas ‘confictual economies (conventionally including Canada, the United States and Great Britain) have traditionally lagged behind in both respects (for a survey and analysis see Gordon 1996).

It is certainly the case, though, that the continental European countries have performed poorly in terms of employment creation in recent years. Fluctuations in the European economic cycle have left larger numbers unemployed whenever there has been an upturn in the cycle (‘hysteresis’). This suggests that employment creation lags behind growth and that the fruits of new growth are not evenly shared between insiders and outsiders (see Ormerod 1998) - a situation much more acute in some countries than others. An acute insider/outside dualism in the labour markets of many of them, created by over-protective regulations for those in full-time, standard employment (see Siebert 1997). But combinations of incremental reform in labour market rules and social security systems, plus certain policies encouraging a redistribution of work (some forms of work sharing, for example) can help mobilize those sections of the unemployed work force left behind by a return to higher levels of growth. In addition, there may have to be some selective deregulation of the labour market to enhance flexible (i.e, part-time or temporary) service-sector employment, and this will form an important part of many continental countries’ labour market strategies.

But as Hall (1998) argues, there is no reason to expect that this will push Europe’s organized, co-operative economies down the slippery slope to Anglo-Saxon style deregulation and inequality. Indeed, periods of high unemployment and painful restructuring in the trough of the cycle seem to have bolstered the search for consensual solutions. Of particular importance is the way in which optimal forms of labour market regulation require collaborative industrial relations as well as corporatist bargains to cement them. For as Nickell (1997) has demonstrated, a number of protective measures that are generally assumed to impede employment creation may in reality have little effect.
These include employment protection measures and general labour market standards, generous unemployment benefits (as long as they are accompanied by strict benefit durations and measures to help the jobless back into work) and high levels of unionization and union coverage (as long as they are offset by high levels of co-ordination in wage bargaining). The best way of tackling this problem is via negotiation, not the unilateral imposition of looser regulation à la Thatcher, coupled with awareness that not all protective employment regulations deter employment creation. Selective deregulation, leading to an expansion of part-time employment, has been achieved in the Netherlands, for example, within the context of a broad social pact sustaining co-ordinated wage bargaining, while also, minimizing the impact on real income disparities (Visser and Hemerijk 1997; van den Ploeg 1997).

**The Emergence of ‘Competitive Corporatism’**

Thus, corporatism has not gone away, either as a mechanism for co-ordinating wage bargaining or for negotiating wider policy options. Indeed, recent years have witnessed the preservation of corporatism in countries where it has always been strong, as well as its emergence in those where the traditional prerequisites (e.g. strong, centralized, hierarchically ordered interest associations) have been weak.

As for the countries of traditional ‘social corporatism’, as argued by numerous analysts (Wallerstein and Golden 1997; Dølvik and Martin 1997), Sweden turned out to be the exception. The collapse of Swedish centralized bargaining system may have had something to do with globalization and the creation of new coalitions within the traded and non-traded sectors. But domestic politics played a particularly important part (specifically the conflict between employers, and unions over new labour laws and wage earner funds in the late 1970s and early 1980s). By contrast, bargaining remains ‘co-ordinated’ in various ways in Finland, Denmark and Norway. In Denmark, where since 1987 wage negotiations have been conducted without confederal participation, the 1990s have seen the emergence of five large bargaining cartels, with even greater controls on plant-level bargaining than in the past. In Norway, centralized negotiations were re-established in the late 1980s after a period of industry-level bargaining. In 1992, following the attribution of legal status to wage bargains struck between the social partners at the national level, the so-called ‘solidarity alternative’ (*solidaritetsalternativet*) was introduced in the form of an informal understanding between the government and the trade union confederation, LO. Its aim - which has been achieved - encourages moderate pay increases in order to strengthen the competitiveness of Norwegian companies and reduce unemployment. Its success in bringing down inflation and unemployment levels has led the Swedish government to find ways of emulating it. In Finland, a reunification of blue-collar unions in the late 1960s, linked with government participation in tripartism, has *increased* centralization (Wallerstein and Golden 1997). Meanwhile Austria - whose economy has achieved higher levels of openness and tertiarization than even Sweden’s - has also remained highly corporatist, although with
considerable flexibility in its wage bargaining structures (Traxler 1997a; Wallerstein, Golden and Lange 1997).

As for countries in which a defunct corporatist tradition has been revitalized, or a new one put in place, the Netherlands takes pride of place. After an interlude of industrial relations strife, the mid-1980s saw a revival of Dutch corporatist policy making - again with flexible, decentralized bargains within a co-ordinated structure. This has produced something of a model for advocates of a ‘third way’ between highly regulated continental Europe, and the more deregulated economies of Britain and the United States. Dutch social concertation has provided the basis for industrial relations peace, wage moderation and an ongoing process of labour market rereregulation while preventing an increase in inequality and combating unemployment (now one of the lowest in the OECD). There have also been agreements on social security contributions, work sharing and industrial policy, training, job enrichment, the development of ‘entry-level’ wages and, in 1995, rights for temporary workers were strengthened (the so-called ‘flexicurity’ agreement) in return for a loosening of dismissal protection for core workers (Visser and Hemerijk 1997). Other examples abound. In Ireland, a rather comprehensive social pact negotiated in 1987, 1990 and again in 1993 has addressed tax, education, health and social welfare issues in addition to incomes. The emphasis has been on inflation-proof benefits, job creation and the reform of labour legislation in the areas of part-time work, employment equality and unfair dismissal. Pay rises have been subject to floor and ceiling levels. In return, trade unions have delivered industrial relations harmony. In Italy, negotiations in the early 1990s that initially focused on reforming Italy’s automatic wage-indexation system were extended to include the rationalization of bargaining structures, the reform of union representation in the workplace, improvements to the training system, the legalization of temporary work agencies, assistance for the unemployed to enter the labour market and, the most significant step, the May 1995 agreement between the unions and the government on pension reform. In Portugal, there have been five tripartite pacts since 1987 focusing on incomes and social and labour market measures, including pay-rise ceilings and loosening rules on the organization of work, the termination of employment and the regulation of working hours. The 1996 agreement also covers social security issues, including a minimum wage, a reduction of income tax for low income groups, and a more favourable tax treatment of health and education benefits and old age pensions. In Spain, a long period of unilateral employer and government decision making (and considerable blockage in welfare and labour market reform) has given way to a new national bargain – the Toledo Pact. This agreement has allowed progress (albeit rather limited) on pensions’ reform and (more significant) innovations in labour market flexibility (Rhodes 1998a). In all of these countries the public domain is being reconfigured and strengthened, via a realignment of relationships between public and private sector actors behind new objectives. In those countries with the traditional institutional pre-requisites for successful corporatist bargaining (primarily strongly centralized trade union and employers’ organizations), these structures are being loosened and made more flexible and the objectives of the bargain are frequently renegotiated. In those countries without those institutional prerequisites, these are being put in place (albeit on a much more fragile basis than in the former countries) as part of the bargain itself. In other words, representation and organizational cohesion are being negotiated into place as a means of
consolidating the wider deal. At the same time, a complex process of issue linkage between related policy areas is to some extent providing a ‘functional equivalent’ of organizational strength, by expanding the coalition of interests that can thereby be accommodated within the bargain. This process has profound implication for the scope and role of the public domain as a complex web spanning public and private interests in these countries.

How does this process work? If we take the objectives of these pacts, and consider their final goals, we can construe them analytically in terms of the constitution of two types of coalition - distributional coalitions and productivity coalitions - and the attempt to forge effective and enduring political and functional linkages between them. Although differing, sometimes markedly, from one country to another, these pacts derive precisely from a common attempt to link negotiations over both the formal and informal welfare states (i.e. formal welfare programmes and the labour market component of the social wage) with more general policies to bolster competitiveness. Some countries (the Netherlands, Denmark) are simultaneously building both types of coalition. Others have been relatively successful in creating a new distributional coalition (Ireland) but have been less successful – although progress is being made - on the productivity side. Italy is struggling to find the distributional support for further reform of the pensions system (given that half of the membership of all three of its major union confederations are pensioners!), but important gains have been made in negotiating productivity gains in industry. Although slower and perhaps less incisive reformers, all of these countries have thus far avoided the dramatic increases in social inequality that have accompanied the radical reforms imposed unilaterally in the liberal welfare states of the United Kingdom and New Zealand.

We can hypothesize that the most enduring examples of competitive corporatism will be those that create the most complete coalitions of both types and forge the most functional links between them - functional, that is, for a politically acceptable and legitimate trade off between equity and efficiency. Importantly, even those countries without the pre-requisites of traditional social corporatism – i.e., strong, well-organized and centralized employers and union movements – can engage in this process of exchange. As the examples of Italy and Ireland show, broadening the bargain to include industrial and structural with employment policy, and making the institutionalization of co-operation between the parties an element of negotiation, can provide the functional equivalents of traditional corporatist preconditions (Traxler 1997b). Moreover, partisan politics appears to be becoming less important for such pacts. In the Irish, Portuguese, Spanish and Dutch cases, centrist, socialist and center-right parties have governed at various points in the process of building or consolidating concertation. We can also therefore hypothesize that, partly in response to the pressures mentioned below – in particular the constraints of EMU – the economy is becoming much less central to ideological conflict and party politics in these countries than hitherto (see Rhodes 2000 for a more extensive analysis of these developments).

What sort of policies do these new pacts embrace? The most important ideal objectives would appear to be a co-ordinated decentralization of bargaining structures and an ordered re-regulation of the labour market, accompanied by adjustments to tax and social security systems to avoid a reduction in real incomes or social security protection. Although they tackle a wide range of issues,
spanning incomes policy, social security and tax reform, employment and the labour market provide examples of ways in which new techniques and new modes of negotiation have proven to be critical for policy innovation and policy success. The debate on social protection and employment has focused on several types of reform. These include: modifying the funding of welfare by shifting the burden of costs, for example, away from pay-roll taxes to general taxation; removing tax wedges and eliminating poverty traps; introducing wage subsidies in various forms to employers and ‘in-work’ benefits; and, more specifically, the ‘activation’ of so-called ‘passive’ benefits. Examples of radical proposals made in this area are conditional negative income taxes (i.e. conditional on, for example, evidence of serious job search by an unemployed person); and benefit transfer programmes (e.g. providing individuals with vouchers that could be offered by the unemployed to firms that would hire them, reducing correspondingly the amount of public money spent on traditional forms of unemployment benefit). Denmark and the Netherlands and Ireland have perhaps gone furthest in experimentation in these areas, and in all three cases reforms have been introduced within a general context of policy concertation. As can be seen, the policy linkages between social security, employment and fiscal policy are complex but essential in making welfare institutions more responsive to the demands of internationalized, and post-industrialized, societies. Without such innovations, the ‘quicksand’ effect of welfare discussed in the first part of this article would quickly be felt.

Why is this happening? Part of our understanding of these corporatist or quasi-corporatist developments must come from an acknowledgement of the contradictory - although quite logical - tendencies at work. On the one hand, as many who forecast the demise of corporatism correctly pointed out, decentralization in formerly centralized industrial relations systems has been induced by a combination of factors. The new international division of labour within large transnational firms and the introduction by multinationals of ‘alien’ elements into national bargaining arenas has been a disturbing factor. Cross-class ‘flexibility’ alliances between employers and workers have eroded social corporatist systems to some extent, inducing a shift to a more sectorally based form of bargaining (e.g. some Scandinavian countries). Meanwhile, employers in all systems are searching for greater company and plant level flexibility in three areas: internal (or functional) flexibility in the work place; external (or numerical) flexibility vis-à-vis the wider labour market; and greater pay flexibility at local levels. At the same time, the creation of the single market and the realization of EMU have placed new pressures on wage-cost competition and made competitive devaluation impossible.

However, there are also pressures in favour of centralization - as well as high levels of national (and European) employment protection; and some of these derive from the very same forces that are ostensibly ‘disorganizing’ the advanced capitalist economies. As already argued above, in response to competitive pressures, the diffusion of new forms of ‘best practice’ human resource management and work organization implies the creation or maintenance of co-operative labour relations and a high-trust firm environment. And contrary to the general assumption that new types of organizational flexibility inevitably strengthen capital at the expense of labour, employers and workers become increasingly interdependent in such systems. Well-designed labour market rules also remain essential in this context. For the optimal world of internal flexibility is built not by unilateral management action but on teamwork and low levels of hierarchy in firms. It also depends not just on
high levels of skills but also on the acquisition of skills within national education and training systems. Too high a level of external flexibility – i.e., the absence of regulatory constraints on firms - destroys trust and undermines internal flexibility. This trade off - producing a productive form of ‘regulated co-operation’ - is a critical one for sustaining both competitiveness and essential levels of trust and consensus in European labour markets.

Furthermore, cost competitiveness and monetary stability – as well as ‘credibility’ with international financial markets - require a means of preventing wage drift and inflationary pressures. This has focused the attention of governments on revitalizing incomes policies, a critical component of many if not all of these new national bargains. This imperative, for example, lies behind recent attempts to put in place a new national framework bargain in Spain (Pérez 1999). Thus, rather than disrupting concertation and fragmenting governance in the European labour market, the completion of the single market and movement to full EMU is likely to lock bargaining partners in the public domain more closely together. This is precisely why social pacts, which have had at their core an incomes policy strategy anticipating monetary union, have been consolidated during the 1990s in countries seeking – and subsequently thereby achieving – EMU membership. Even before the launch of a single currency, the joint search for consensual, yet flexible, solutions to problems of pay, employment and competitiveness became a paramount objective, changing the behavior of national employers and trade union organization and leading to innovations (generally a centralization) in wage bargaining (Rhodes 1998a).

This argument runs counter to predictions that EMU will ‘disorganize’ European industrial relations. Martin (1998) forecasts three ‘possible futures’ for European wage bargaining. First although co-ordinated internally, EMU might turn national bargaining arenas into one single uncoordinated bargaining structure across the EMU area as a whole. ‘Unions in all regions could thereby be drawn into a deflationary vicious circle of labour cost dumping, or competitive internal depreciations’ (i.e., wage and benefit cuts) in an effort to bolster price competitiveness in lieu of currency depreciation’. Another alternative might be the emergence of cross-border co-ordination of wage bargaining within particular sectors, such as engineering, given that the German IG Metall has already played a role in co-ordinating wage bargaining in this sector the D-Mark zone. But while this is a much more distinct possibility than co-ordinated bargaining across the EMU countries as whole, it is much less likely than what Martin (1998: 21) refers to as ‘re-nationalization’ of wage bargaining. Although he does not define this precisely, this notion fits with the resurgence of national wage co-ordination via limited trade-offs between jobs and wages and benefits or broader ‘social pacts’ of the type discussed above. As this article argues, this is not just a more likely future scenario: it is a contemporary reality. Given that coping with EMU convergence and other pressures for centralization have helped put in place or consolidate corporatist arrangements, varying from the fragile to the strong, depending on the country and national traditions, there is no reason to suspect that full monetary union will alter this institutional landscape enormously. If anything, the imperative for incomes policy and collaborative employment and social policy making becomes greater.

Of course, as is already evident from the above ‘competitive corporatism’ is far from being a uniform phenomenon. Nor does concertation or corporatist bargaining necessarily confer economic
success. There are also a number of criticisms, including most potently the claim that, in the absence of a co-ordinated expansion of European economy, supply-side innovations and union concessions to labour market flexibility may simply redistribute employment rather than help create it. But there are significant differences in economic performance among countries maintaining large welfare states alongside neo-corporatist bargaining systems and powerful union movements, as well as among those with more flexible social pacts. A recent study by Casey and Gold (1999) suggests that the worst performing countries in this category are Austria, Germany and Spain – all of which have or have had neo-corporatist industrial relations systems with strong ‘insider-outsider’ divisions and are strongly resistant to change. They have proven particularly poor in responding to the needs of ‘outsider’ workers – in terms of income security or social protection – especially the unemployed, younger, female or older workers. By contrast, the Netherlands, Sweden and Ireland have shown a capacity to adapt, fostering employment creation and economic growth – despite a restrictive fiscal and monetary climate. As their example also shows, by contrast with the liberal welfare states (the UK, New Zealand, the United States) it is possible to respond to both domestic and international pressures for welfare and labour market change without also sacrificing aspirations for reconciling social equity and justice with growth.

3. Conclusions

The policy implications of the above analysis is that neither welfare state retrenchment nor labour market deregulation is necessary for an economy to remain competitive in the ‘global era’, although realizing particular policy objectives – and boosting employment creation – will certainly mean redesigning welfare systems. This latter process of innovation brings with it an intensification of negotiations and relationships in the public domains of most European countries. Nor, it should be added, is there any a priori justification for an all out assault on the public sector as such. Reviewing econometric cross-national analyses of the impact of the public sector on economic performance, Mosley and Schmid (1993) argue that there is no convincing evidence that this is negative. On the contrary, the public sector, and in particular efficient public services, are an important institutional condition for competitiveness, especially in innovative, high-skilled, and high-value added forms of production. To achieve this goal, social and welfare policies should be part of an institutional ensemble that fosters long-term relations of trust: close links between companies that foster effective systems of training, co-operation in export marketing, R&D and the provision of long-term finance; relations in firms that stimulate a longer-term product development strategy, ensure a better educated and more co-operative workforce and make managers more technically competent and willing to invest in company-specific skills (Soskice 1991; Casper and Vitols 1997).

A parallel argument concerns protective labour market regulation. Rather than hampering economic performance because of alleged price distortion, many forms of protective labour market enhance productivity and are beneficial for economic development. Thus, minimum wages pressure firms into finding ways to raise productivity, whether through technological innovation or through training. As long as they are designed so as not to create or accentuate an insider/outsider dualism
in the labour market, employment security regulations will improve the worker’s commitment to the enterprise, creating trust and enhancing forms of work flexibility (see e.g. Standing 1991; 1999).

In sum, the institutions required to build and sustain trust in the public domain are compatible with internationalization. For not only do open economies seem able to sustain strongly unionized environments, but corporatist bargaining structures remain important in those economies increasingly exposed to international forces. As Lange and Scruggs (1997) explain in their study of the relationship between globalization (measured in terms of trade, financial flows and foreign direct investment) and unionization rates, there is a contingent effect on labour strength. Unions which have historically done better under economic expansion, need not be damaged if new markets for traded goods (involving product market deregulation) are produced in more unionized sectors or if capital flows and inward investments are directed towards such sectors. At the same time, different types of capital and investors are likely to seek different kinds of investment opportunities: as long as they are productive, unionized sectors and national economies may well be as successful - if not more so - than less unionized ones. As discussed above, far from disaggregating organized interests and collaborative relations with business and government, internationalization has at most modified and in some cases actually strengthened them. As shown by the persistence of co-ordinated bargaining in traditional corporatist countries and the emergence and consolidation of new forms of social partnership elsewhere, the future for most continental European economies is neither neo-liberal nor one of conventional social corporatism but rather one of flexible, pragmatic, productivity-oriented social pacts – in other words, a European ‘Third Way’. The ‘new politics’ of welfare and employment will revolve around the means and modalities of sustaining such bargains in an era of permanent change.
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