

A triumph of failed ideas

European models of capitalism in the crisis

Edited by
Steffen Lehndorff

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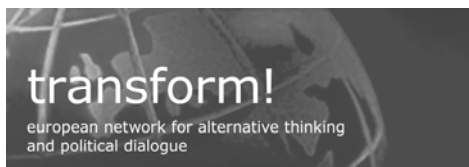
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Steffen Lehndorff

European Trade Union Institute (ETUI)

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The chapter written by Steffen Lehndorff and that contributed by Hans-Jürgen Urban were translated from the German and the chapter co-authored by Florence Jany-Catrice and Michel Lallement from the French by Janet Altman.

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The triumph of failed ideas

Introduction¹

Steffen Lehndorff

'Self-regulation that manages everything, that's finished. Laissez-faire, that's finished. The market which is always right, that's finished.'

Nicolas Sarkozy, 25 September 2008²

Trichet: 'The market is always right. And it has to be fully respected at all times.'

Question: 'I am sorry, you said that the market is always right?'

Trichet: 'Yes, I said the market is always right.'

Jean-Claude Trichet at a press conference, 8 April 2010³

1. Introduction

Some might argue that neither President Sarkozy nor (then) President of the European Central Bank (ECB) Trichet were entirely serious when they made the statements quoted above. Sarkozy knew what many people wanted to hear in the autumn of 2008, quite apart from the fact that he would never agree that anything or anybody should be allowed to regulate itself or even to be right unless he himself gave the order or advice. Naturally, that also applies to any notion of a 'refoundation of capitalism'. Thus, his statement had a tactical aspect. Trichet, too, was

1. I am grateful to the other contributors to this book for their valuable contributions and comments. Needless to say, responsibility for the views expressed and conclusions drawn in this introductory chapter is all mine. Many thanks also to Janine Leschke for her extremely efficient coordination of the publication and to James Patterson for his careful copyediting of the text. It was a great pleasure to collaborate with them and with all other people who made this publication possible.
2. 'Le président de la République veut refonder le capitalisme.' Discours du 25 Septembre à Toulon. Available at: <http://www.gouvernement.fr/gouvernement/le-president-de-la-republique-veut-refonder-le-capitalisme>
3. Jean-Claude Trichet, President of the ECB, Frankfurt am Main, 8 April 2010. Introductory statement with Q&A. Available at: <http://www.ecb.int/press/pressconf/2010/html/is100408.en.html>

to some extent arguing tactically when he insisted that the ECB President would never comment on bond or currency market movements.⁴ On the other hand, both were serious insofar as they reflected, or even reinforced, a dominant trend at the time, either in public debate or – in the case of Trichet – elite circles. While the public debate has been diffuse, multi-faceted and erratic from the beginning, core elements of elite opinion have maintained a determined course throughout the crisis, albeit cautiously at the beginning. It is precisely this ‘strange’ combination of anti-neoliberal rhetoric on the one hand, and the stubbornness of those in power amidst chaos and disorientation on the other, which inspired Colin Crouch (2011) to write about ‘the strange non-death of neoliberalism’, and Paul Krugman (2010) to comment in his New York Times column on ‘the strange triumph of failed ideas’ (a phrase which provides us with our title). In the present publication we consider the implications of this non-death and triumph for the economies and labour markets of ten European countries.

2. What brought us together

To publish such a book in these times is a delicate operation. As an editor, authors have to be issued with deadlines and in one e-mail I reminded some of them that we should try to finish before the euro collapsed. It was intended as a joke, but who knows. One author replied that it was so difficult to finish because new developments were succeeding one another so rapidly. Indeed, the present volume does suffer from this difficulty. However, when we started our joint work we knew that this was unavoidable, but also that in any case our topic goes beyond the economic policy roller-coaster ride of the past three years. What concerns us are the changing models on the basis of which Europe’s economies and labour markets are organised. The background of our undertaking is the intense academic debate on the persistence and importance of the various ways in which capitalism is organised, including the institutions that shape welfare regimes, labour markets and national production systems. While neoliberalism had gained its

4. Moreover, during his last year in office in 2011, he demonstrated his tactical abilities when he deviated from his own beliefs by occasionally allowing the ECB to interfere with sovereign bond markets against the fierce resistance of Bundesbank dogmatists.

political and economic as well as media domination in the 1990s, the academic literature on the various ‘worlds of welfare capitalism’ (Esping-Andersen 1990) and ‘varieties of capitalism’ (Hall and Soskice 2001) began to make a strong point against mainstream ‘one best way’ and ‘there is no alternative’ (TINA) thinking. One crucial aspect of this literature was that, while individual capitalist countries may achieve similar economic success despite different institutional settings, these settings – or ‘models’ – may impact substantially on the quality of social outcomes. Hence the message that institutions still matter.

But what about the changes, or even ruptures, experienced by such models? This simple question brought together the present group of researchers from ten European countries to look at the ‘dynamics of national employment models’, as we called our three-year research project, which ended in 2007. The country-specific findings indicated that, over the past 20 years, most existing national models had been driven – albeit on the basis of different premises and to varying extents – to develop growing tensions and vulnerabilities due to increasing inconsistencies within their institutional architectures. Core elements of the EU single market strategy had contributed to destabilise existing models (‘negative integration’), given the weakness of countervailing powers aimed at social institution building at both national and EU levels. The bottom-line of our findings, therefore, given both external (for example, ‘globalisation’ and ‘Europeanisation’) and internal (for example, demographic change) pressure for change and their interaction within a neoliberal mainstream, was that there was a growing need for ‘multi-level institution building’ aimed at revitalising national employment models in Europe.⁵

When our research project ended, the crisis began. This experience made us wonder whether our findings might be useful in developing a better understanding of what has been happening since 2008. To exchange views on this topic we met again, in spring 2011, with

5. The main findings of the EU-funded DYNAMO project were published in Bosch, Lehndorff and Rubery (2009). A second book (Anxo, Bosch and Rubery 2010) focused on the welfare state. Sector-focused cross-country comparisons have been published in the journal *Work Organisation Labour and Globalisation* (Huws, Lehndorff and Grimshaw 2010). For other publications and further details, see <http://www.iaq.uni-due.de/projekt/iat/dynamo.php>

extremely helpful financial and organisational support from the Foundation of the European Left, *Transform! European Network for Alternative Thinking and Political Dialogue*. The discussion focused on three questions:

- To what extent did changes in national models before the crisis help to prepare the ground for the crisis?
- How have the models fared during the crisis?
- Which lessons have been drawn, and what are the challenges and choices faced by national actors regarding the future of the respective socioeconomic development models?

The following chapters of the present book include the ten country analyses whose main ideas were discussed at the meeting, as well as the contribution by Hans-Jürgen Urban, member of the executive board of the German metalworkers union IG Metall, on the prospects of trade union policy in Europe. Last but not least, it also includes a study on current austerity policies and their interaction with the new approaches to economic governance at the EU level, written by Janine Leschke, Sotiria Theodoropoulou and Andrew Watt of the ETUI. This analysis provides an important complementary view and we are more than grateful that the ETUI was interested in contributing to – not to mention funding and publishing – the present book.

While it is definitely far too early to expect profound foresights, the present status-quo analyses provide insights into national ways of coping – or non-coping – with the ongoing crisis. These insights will hopefully provide a better understanding across borders at a time when European rhetoric is being used as a smokescreen for national egoism.

3. Varieties of vulnerability

The chapters of the present volume underscore that it is both misleading and superficial to summarise the current economic turbulence – as is now routine in mainstream media and politics – under the heading of ‘public debt crisis’. What is happening now is rooted – to be sure, in a variety of ways, depending on the country – in the destabilisation of national models of capitalism due to the predominance of neoliberalism since the demise of the post-war ‘golden

age'. More precisely, the combination of 'financialisation' (Foster and Magdoff 2009), EU internal market policy and European Monetary Union, on the one hand, and the weakening of regulatory and welfare institutions within most EU countries, on the other, have given rise to serious imbalances within the EU and contributed to imbalances in the world economy (Krugman 2008; Coates 2011). It is nothing less than the very concept and architecture of the Eurozone that have been overwhelmed by a deep crisis. Becker and Jäger (2011) portray it in terms of the 'unfolding contradictions between different national capitalisms, characterised by [broadly] financialised or by neo-mercantilist regimes of accumulation': in other words, a monetary union between an export-focused and surplus-oriented core and a periphery that is dependent on imports and capital inflow has proven to be fatally flawed and unsustainable.

The country chapters reveal the extent to which the respective country-specific socio-economic development models (to go beyond the possibly limited scope of the term 'growth model') are either unsustainable for the respective country or unsustainable for other countries. The chapter on Greece gives the most impressive example of the former, the one on Germany the most striking example of the latter. Moreover, in the case of Germany – but arguably also in the case of the United Kingdom due to the supreme importance of the City of London – these socio-economic models are sustainable neither for the country in question nor for the rest of Europe.

Unfortunately, the short intermezzo of massive stimulus packages, while extremely important for short-run recovery, by and large failed to include expenditure geared to fostering more sustainable structural change. Indeed, as Leschke, Theodoropoulou and Watt (in this volume) conclude, 'the crisis could and should have been used as an opportunity to introduce corrections to the previous growth model, in which rising inequality was a prominent feature'. It is in the same vein that Hans-Jürgen Urban argues that the social pacts in some countries – most notably Germany and Austria – while proving essential in preventing the crisis from doing serious damage to the labour market, have failed to pave the way for future pre-emptive policy approaches.

It is clearly important to reveal the ill-advised economic policy approaches which are currently leading the Eurozone and the rest of the

EU towards disaster. The emphasis of the present publication, however, is different and may be regarded as a complementary contribution to current non-mainstream economic analyses. The analyses of individual countries highlight the importance of *interaction between economic and institutional changes* both within countries and between countries and the EU. In retrospective, it is this interaction that helped to prepare the ground for the expansion of the combined financial crisis and deep recession of 2008 into a chain reaction of interrelated crises in financial markets, public finances and – in some countries – ongoing recessions. Moreover, as demonstrated in the chapter on EU-level economic governance, the same happened – and the situation continues to deteriorate – with regard to the formation of a Eurozone fiscal policy authority without democratic legitimacy. Our earlier joint research project recommended ‘multi-level institution building’ in Europe and this need is being driven home every day as the European crisis deepens. In fact, both at the EU and the national level, the interaction between unsustainable growth models and the deficiencies of welfare, labour market and economic governance institutions makes it particularly difficult to find ways out of the crisis. This, in a nutshell, is the story told in the ten country chapters, summarised in Table 1.

Table 1: From North to South: pen sketches of European models of capitalism before and during the current crisis

	Type of model*	Characteristic change in the 1990s and 2000s	Tensions/unresolved issues before crisis	New trends/emerging tensions since 2008
Sweden	CME Social democratic welfare state	Revitalisation through reestablishment of model (macroeconomic controls, social contract) plus new pillars, such as innovation	Combining labour standards with product market deregulation but under threat from EU. High taxes still a political challenge	Core components of model only marginally modified, and rise in public deficit limited; but increasing duality of labour market, deteriorating employment prospects for young people/immigrants/low skilled, weakening of trade unions through unemployment insurance reform
United Kingdom	LME Residual welfare state	Reinforcement of market model. Revitalisation through new social pillars	Fragility of model based on financialisation, housing and consumer credit. Segmentation of labour market continues despite improved public services/higher minimum social guarantees	Massive turn towards austerity, weakening of public services and welfare, withdrawal of state in favour of private sector. Policies likely to cause rise in poverty and regional inequality

Table 1 (cont.)

	Type of model*	Characteristic change in the 1990s and 2000s	Tensions/unresolved issues before crisis	New trends/emerging tensions since 2008
Ireland	LME Residual welfare state	Hailed as role model for neoliberal development (low tax, flexible labour market), legitimated by substantial rises in cash wages and employment, eased by 'social partnership'	Model depends on continual inflow of FDI but this in turn involves zero sum competition with EU member states; low social investment means immigration instead of development of labour force; commitment to light-touch regulation ensured Eurozone entry but opened door to massive speculative lending and hence property bubble	Way out of the crisis seen as consolidation of 'Boston not Berlin'; even deeper reliance on (US) FDI as saviour; further marginalisation of trade unions
Germany	CME Conservative welfare state	Upheaval and fragmentation; neoliberal reorientation of major actors in the wake of unification	Successful reform of production system but model challenged by rise of less regulated service sector, problems of unification, lack of universal labour standards and an outdated family/welfare model, deepening labour market segmentation and social inequalities	Strong pressure for 'green growth' but ever growing dependency on exports, deficient public investment and services aggravated by austerity approach, ongoing resistance to statutory minimum wages and modernisation of family/welfare model
France	CME/state-led Continental welfare state	Conversion – from state-led to state-enhancing	Privatisation and decentralisation of the state but the state has expanded role in providing minimum income guarantees and other forms of support for the unemployed, particularly the young	Persistent unemployment and increasing dualisation of labour market; upcoming issues: public spending cuts, tax reforms, ever increasing social and regional inequalities
Austria	CME Conservative welfare state	Conversion – from demand-led to supply-led corporatism	Continuity of corporatism, with continuing regulation of labour standards associated with major changes in political context. Failure to modernise family and welfare policy	Revival of social partnership, ever increasing dependency on exports and on Germany, banks highly dependant on CEE

Table 1 (cont.)

	Type of model*	Characteristic change in the 1990s and 2000s	Tensions/unresolved issues before crisis	New trends/emerging tensions since 2008
Hungary	Post-transition Legacy welfare state	In search of a model- oscillating between Anglo-Saxon and Rhenish models	Period of high FDI inflows has left country exposed to credit crisis; problem of reconciling demand for strong welfare state with poor value added base	Heavy public and private indebtedness, severe cuts in public services and welfare transfers, weakening of labour market regulation and industrial relations, taxation favouring upper-middle class, centralisation of government power/right-wing populism
Greece	State-led Familialist welfare state	Tensions between increase in female employment rate and familialist model. From state-led to liberal, shrinking core and enlarging periphery	Liberal reforms not leading to new forms of comparative advantage. Limited de-familialisation, in part because of low tax base	Collapse of the socio-economic model, acceleration of transition to liberal capitalism with residual welfare state. The problem of comparative advantage remains unresolved
Italy	CME (north – under-developed south) Familialist welfare state	Tensions between development and familialist model – shrinking core, enlarging periphery	Only 'limping reformism': problems of 'frozen specialisation' in consumer goods vulnerable to delocalisation, continuing problem of segmented/incomplete welfare coverage. Widening regional inequalities (North/South divide). Low tax base to support reforms	'Delayed reforms and misguided policies': further increase in income and regional inequalities and labour market dualisation, lack of industrial policy; bureaucracy, tax evasion and regressive taxation
Spain	CME Familialist welfare state	From CME to liberal. Tensions between development and familialist model.	Liberalisation of model resisted at national level only by trade unions – limited influence in workplace. Strong dualisation of labour market. Some recent but limited changes to familialist welfare model. Reliance on housing market resulting in exposure to the credit crunch	After bursting of real estate bubble: very high (youth) unemployment, absence of industrial policy incl. vocational training, fragmentation of collective bargaining fostering low-wage strategies, significant public spending cuts, 'prospects are dramatic'

Note: * According to typologies in literature on varieties of capitalism (LME = liberal market economy, CME = coordinated market economy) and varieties of welfare state.

Sources: Bosch, Lehndorff and Rubery (2009); authors of present publication; own portrayal

The bottom-line of the pen sketches in Table 1 is that, with very few exceptions, the ‘varieties of capitalism’ in Europe can today be depicted as ‘varieties of vulnerability’. The nature and depth of the specific economic and social problems of the countries analysed do differ substantially, even with regard to the magnitude and importance of sovereign debt whose country-specific causes are highlighted in the respective chapters. What all national models have in common, however, is that they have become increasingly vulnerable in the course of the current crisis, if sometimes for very different reasons.

Most disturbingly, the chapters on Hungary and Greece, but also the one on Spain suggest that the term ‘vulnerability’ may be an understatement. In these countries, the very foundations of future economic and social development are at stake. Italy differs from this group of countries due to its still dynamic manufacturing industry in the north, but this potential could be developed and exploited for the benefit of the country as a whole only through massive reforms of the state. The United Kingdom, in turn, will be more dependent on the City of London than ever, given the ongoing massive job cuts in the public sector which, in the decade before the crisis, had made a disproportionately high contribution to job growth compared to the private sector. Ireland, arguably, is providing the most contradictory picture of all the countries analysed in the present book, as the catastrophic conversion of private debts into public ones has triggered massive cuts in public expenditure, while the reliance on export-driven FDI, as James Wickham puts it, has become a ‘national fetish’ (turning the interrelated low corporate tax rate into a ‘symbol of national independence’).

In contrast to the sometimes devastating prospects described in these chapters, Eurozone countries Austria, France and Germany (together with Sweden) appear to be performing much better. However, while the French economy has been less affected by the recession than the other two because it is more dependent on the domestic market, social and regional inequalities are on the rise and long-standing deficiencies – youth unemployment in particular – justify serious doubts about sustainability. Austria, in turn, is becoming more and more dependent on its export industries and on the ups and downs in Germany, while its banking system is particularly exposed to the future of the highly indebted private sectors in Central and Eastern Europe. With regard to Germany, it is important to understand how the weakening and

neoliberal modification of labour market and welfare institutions over the past ten years have exerted enormous downward pressure on average wages, thus contributing to the paradoxical effect that this alleged growth engine in fact functions as a major millstone for Europe.

Sweden may be regarded as the only outlier in our present set of countries as its social equity model has survived the recession basically undamaged and continues to enjoy undiminished support among large segments of society. Nevertheless, unemployment (in particular among young people, immigrants and low-skilled workers) remains at levels unacceptable for this country, giving rise to attempts by the present government to cautiously weaken some pillars of the traditional model through the back door (most prominently by a reform of the unemployment insurance system geared to reduce trade union influence), leading to even more problematic social outcomes. After the recession there may be another push towards greater duality between insiders and outsiders in the Swedish labour market, which leaves Dominique Anxo concerned about the possibility of a 'progressive decline of the Swedish model, its coherence and the robustness of its social cohesion' in the future.

Apart from Sweden, with its – if only when compared to other countries – modest changes, the following chapters provide a clear overall picture. Things were far from perfect before the crisis, but now they are rapidly getting worse. In the aftermath of the 'great recession', austerity policy dominates the scene. The obsession with cutting public expenditure is undermining or even blocking the road to recovery and the revitalisation of socio-economic models. These roads are different in each country, but they are being obstructed almost everywhere. What we are witnessing is the resurrection of a neoliberal 'There is no alternative' approach under a new heading.

4. TINA reloaded: like lemmings to the sea

In most of the countries analysed in the present volume, the outcomes of the 2008/2009 crisis are being tackled in practice on the basis of core guidelines of neoliberalism. Free-market fundamentalism is being called into question rhetorically, but neoliberalism is being resurrected,

despite the strong public feeling that ‘those who are responsible for the crisis should pay the bill’.

This balancing act is based on the assumption that curbing public debt is essential for everything: in the short term, it is the prerequisite for putting an end to speculative attacks on the government bonds of ‘endangered’ countries; in the short and medium terms, it is needed to provide the ‘confidence’ needed to clear a path for economic recovery; and in the medium and long terms it is the only way of preventing ‘our children and grandchildren from paying the bill for us living beyond our means’. Hence, once again there is no alternative’ (TINA). And if this dogma loses support among believers and the power of the myth starts to fade, it will be as Goethe puts it in his poem ‘Erlkönig’: ‘And if you’re not willing I will use force’⁶

The all-encompassing focus on public debt is remarkable, not least because this implies that the victim is declared guilty. Public debt is not at the root of the current crisis, and anybody who has the slightest doubt in this respect should look at the figures and arguments presented by Leschke, Theodoropoulou and Watt in their chapter on EU-level policy. Joseph Stiglitz made a good point in an interview with a conservative German newspaper that ‘no government has ever wasted so much money as the U.S. financial industry’ (FAZ 2011).

This critical stance has meanwhile found support from large-scale analyses published by the IMF in which it is concluded that short-run fiscal consolidation has proved to be ‘contractionary, not expansionary’, thus boosting unemployment and income inequality and ‘adding to the pain of those who are likely to be already suffering the most’ (Ball *et al.* 2011, p. 22).⁷ What is more, in the same IMF publication Kumhof and Rancière (2011) present their data evaluation showing that countries in which inequality has increased saw a corresponding worsening of their

6. According to the myth the ‘Erlkönig’ is an evil spirit that lies in wait for unsuspecting travellers. However, unlike in Goethe’s poem, Europe’s contemporary Erlking – or perhaps one might say ‘Erlqueen’ – is visible to everyone. Nevertheless reality comes close to Goethe’s concept as Erlqueen and all minor Erlkings alike never tire of emphasising that it is ‘the markets’ that have to be ‘convinced’, which assumes implicitly that actors are invisible.

7. These authors plead for a ‘slower pace of consolidation combined with policies to support growth’, referring to IMF director Christine Lagarde (*ibid.*, p. 23).

current account: 'As income shares of the top 5 percent increased between the early 1980s and the end of the millennium, current account balances worsened' (ibid., p. 25). It should be noted at this point that, irrespective of whether this leads directly to soaring public debts or primarily to private debts in the first instance (as is shown in the chapters on Ireland and Hungary), the latter have been transformed into public debt. Hence the lesson of these authors neglected so far by the dominant policy approaches: 'In the long run, there is therefore simply no way to avoid addressing the income inequality problem head-on' (ibid., p. 27).

It is reasonable to ask why the focus of dominant policy approaches is on the outcome rather than the causes. However, if one limits one's thinking to logic, sometimes one fails to understand what is happening. Once one takes into account the dimension of power, however, it makes sense. This is what Annamaria Simonazzi in her chapter on Italy describes as 'welfare being replaced by bankfare'. Furthermore, as deplored by Josep Banyuls and Albert Recio in their chapter on Spain, it is also the 'absence of a credible project with clearly designed alternative proposals' at the political level that 'has allowed adjustment policies to be presented as the only realistic response'.

The fundamental importance of the universal focus on austerity can best be underscored by remembering that the 'road to serfdom' as envisaged by Hayek was allegedly paved by the modern (welfare) state that was said to put individuals under tutelage. The notion of the 'small state' has been the core of the neoliberal agenda from its very beginning – a contemporary example is the 'Big Society' approach of the present UK government. Since the early 1980s, justification for the small state agenda has been sought in the free market paradigm. Since 2008, however, this paradigm has lost much of its persuasive power in most European countries. Thus, it has been put into 'just-in-case mode': if you do not believe the blunt message that public debt reflects that 'we' are living beyond our means, you will be convinced by the experience that 'the markets' are punishing us for our lack of belief. The diversion has worked fairly well so far and for the time being it represents a strong sheet anchor for the reinforcement of neoliberalism.

While the 'indignados' in Athens, Madrid and elsewhere are shouting 'We will not pay for your crisis' to their governments and banks,

German (and Dutch, French, Finnish and Austrian) taxpayers are being encouraged by their governments and banks (and their media mouthpieces) to shout back ‘We will not pay for your debt’. True, not everyone has joined in the chorus, which shows the ambiguity of the situation in Germany, as well as in other parts of Europe. However, what has dominated the scene so far is an economic policy approach that puts European integration at risk. The economic foundations of the latter, which over recent decades have increasingly been shaped by the unbalanced agenda of a single market without an equal emphasis on social rights, are proving to be fragile and now may even be turning into a threat to the democratic future of the European Union. Democracy is being endangered by the rise of right-wing populism and EU-scepticism in many countries (Baier 2011) and equally by the lack of democratic foundations for economic governance at EU level, which has begun to interfere with fundamental democratic rights within member states.⁸

For the time being, Hungary may be regarded as the most striking example for the combination of austerity policy and right-wing populism. The present government, with a parliamentary majority sufficient to change the Constitution, is erecting an authoritarian regime intent on protecting the wealthier layers of society while cutting deep into social security, labour market regulation and labour standards. The neoliberal agenda is combined with measures geared to defend the interests of the large groups of private middle class borrowers who are indebted in Swiss francs. This is a severe blow to Austrian banks but helps to safeguard political support amongst the middle classes, which so far has proved to be a particularly smart way to cover up the simultaneous dismantling of welfare institutions protecting the poor.

The focus on public debt rather than on inequality, seconded by the emphasis on spending cuts over progressive taxation and tax rises, is truly the most striking indication of what James Wickham, in his

8. It is telling, for that matter, that before the 2011 parliamentary elections in Portugal the leading opposition party, which was about to win the elections, had to agree on the austerity plan imposed by the EU authorities (or in practice by the German and French governments) before the financial rescue package was agreed. A similar tide of events could be observed in Ireland and eventually Greece. The message sent to the electorate is clear: You may vote, if you like, but it won't really matter.

chapter on Ireland, calls the ‘paradoxes of non-learning’. In some of the countries covered by the present book, even in the short period of time in which this approach has been applied, the outcomes are already worrying. As the chapters on Ireland, Spain, Greece and Hungary demonstrate, the imposed austerity approach is driving these countries even deeper into crisis, while safeguarding ‘socialism for the rich’, as Wickham describes the conversion of private debts into public ones. The crises will persist even when (as may be the case in Spain and even more so in Ireland, in contrast to Greece) the economy, stimulated by foreign demand, picks up occasionally. They are systemic crises in the sense that they reveal the lack of sustainable economic and social development models. Or, as Maria Karamessini concludes with regard to Greece, ‘the shock therapy is killing the patient’.

Other than countries within the Eurozone or, as in the case of Hungary, countries which depend almost exclusively on its economic fortunes, austerity policy in the United Kingdom follows a slightly different rationale. With its independent currency and a central bank which (unlike the ECB) is entitled to act as a lender of last resort, thus providing more leeway for alternative approaches, the ‘Thatcher plus’ policy is being pursued primarily and bluntly on political grounds. As Damian Grimshaw and Jill Rubery make clear, the UK with a sovereign debt to GDP ratio roughly at the level of Germany is suffering an ‘austerity crisis’ rather than a public debt crisis. The ‘Big Society’ rhetoric of the current government can be regarded as complementary to the ‘small state’ but it sounds much more elegant to European ears (and the UK still is, as these authors have highlighted repeatedly, closer to Europe than to the United States). If the ‘cabinet of millionaires’ succeeds, the country’s dependency on the City of London will be greater than ever, at the expense not only of social justice and regional equity but also of the potential to pave the way for a more sustainable model of economic development.

In comparison with these countries and for the time being, austerity policy in France, Austria and Germany but also Italy has been implemented at a more moderate pace so far. However, the unsocial outcomes are obvious already, and the tide will soon rise. As Hermann and Flecker summarise, in Austria too, ‘what caused the problems in the first place are still being called for or actually used as remedies: austerity, privatisation and protection of financial assets’, priorities

which make it 'unlikely that Austria will get off as lightly in the event of a new recession'. There is no doubt, however, that Italy, as one of the countries on the shortlist for speculation against government bonds in the Eurozone, is in a much more difficult situation. On the one hand, the basic industrial structure in the northern regions provides ample potential for keeping pace with international competitors. On the other hand, bureaucracy in the public sector, not to mention corruption, cronyism and organised crime, are obstructing the development of the country as a whole. At the same time, the tax base is much too small for modernisation of the welfare state. As Annamaria Simonazzi puts it, the middle classes have 'managed to avoid paying taxes and turned their tax notices into bonds, underwriting the loans required to finance the deficit'. Under these circumstances simply raising taxes means reinforcing the degressive structure of taxation and punish those who actually pay their taxes. As Simonazzi concludes, tax evasion can be reduced only if the concept of taxes is 'reconnected to the concept of services: people need to relearn that what they pay is for their health, education, kindergartens and elderly care'.

This is proving to be equally pertinent for countries such as Austria, France and Germany, whose public services and welfare systems appear to be in much better shape than Italy's. Indeed, the stories told in the chapters on Germany and Austria put one in mind of those being crucified alongside Brian in the Monty Python film who are encouraged to sing 'always look on the bright side of life'. In Germany, to select the alleged role model, the deficiencies of public investment in education and other crucial social services are striking, given that this country has no other 'raw materials' than the skills of the people living in it. What is more, it has already become obvious in Germany, as in France, that budget cuts are being targeted on social expenditure. The so-called *Schuldenbremse* (debt brake) in Germany, for which the French President found the slightly more glamorous name of 'golden rule' – an obligation enshrined in national constitutions to keep sovereign debt within a certain limit at all times – will cut deep into these states' capacity to act in the coming years, given their predominant unwillingness to enlarge tax bases and reinforce truly progressive taxation. What will prove to be a major problem for Germany, however, will turn out to be a disaster for a number of other countries that have been forced into this cage by the fiscal dictatorship established by the German government.

There is a strange rationale, as described in the chapter on Germany, which makes the leader of the lemmings believe that he or she will not be forced to jump and that, if the others do jump, he or she will not be affected (and even that there may be no abyss at all).⁹ In fact, this rationale is light-years away from the observation of FT commentator Martin Wolf (2011) that ‘in 1815, UK public debt was 260 per cent of GDP. What followed? The industrial revolution.’ Arguably, any possible future ‘industrial revolution’, whatever its nature might be, would desperately need strategic public spending which requires a sound tax base.

5. Challenges ahead

The present crisis is rooted in a combination of policy and institutional failures, and as these failures have occurred at both national and international levels, the challenges facing a reform agenda are multifaceted. What is more, national egoisms are making coordination between economic and political elites very difficult. But establishing across-the-board solidarity and coordination of political initiatives among those who are suffering from the failures of economic and political elites is no easier task. This holds for various groups of people, as can be seen in some countries in which large-scale wage cuts and dismissals are being imposed on public sector employees while workers in the private sector may be relieved by a modest economic upturn, or in those countries where the first stage of austerity measures has focused primarily on welfare benefit recipients. However, it holds even more for people who may be encouraged to maintain their respective helplessness or resignation by right-wing populists; as Tóth, Neumann and Hosszú put it in their chapter on Hungary, in some cases there may exist ‘tacit consent on the part of the majority of a disillusioned society’.

The chapters of the present book do not provide consolation. They simply describe the challenges. The pictures drawn are sometimes a little depressing but this does not necessarily mean that the authors are entirely pessimistic. Due to the widespread public discontent with free-market fundamentalism and financial industry supremacy in many

9. For further insights into what European policymakers have adopted from lemmings, cf. Watt (2010).

European countries, political leaders are walking on thin ice. It is for this reason that, by way of an example, Florence Jany-Catrice and Michel Lallement hope that the French presidential election campaign in 2012 will provide opportunities for a public debate on new approaches to tackling the European crisis and the rising social inequality. Similarly, looking ahead to the federal parliamentary elections in Germany to be held in 2013 at the latest, and the massive popular movement in 2011 against nuclear energy which forced the present government to make a sudden U-turn on one of its core issues, political prospects for Germany, too, are not only bleak. The challenges described in the following chapters, however, point to the complexity of the challenges ahead. This is what Hans-Jürgen Urban means by a 'mosaic left', namely a 'Europe-wide movement, a heterogeneous collective player, consisting of different initiatives, organisations and personalities'. He calls for a 'multi-layered perspective [which] must find its way into the trade unions' debates on strategy.'

The term 'multi-layered' is crucial. The conclusions to be drawn from Leschke, Theodoropoulou and Watt's analysis of EU economic policy governance is unambiguous. The EU single market project in general and EMU in particular are fatally flawed due to their unbalanced focus on free markets without adequate countervailing social and labour standards, and on price stability and austerity without adequate reference to sustainable economic development, employment and social equity. The current 'juggernaut of neoliberal policy reforms', as Damian Grimshaw and Jill Rubery put it, is driving the European project onto the rocks. An array of substantial reforms in both the short and the medium term is needed to prevent this from happening (for overviews on the debate on the most urgent reforms, see EuroMemo Group 2010; Degryse and Pochet 2011). Given the ongoing crisis of the financial system the most obvious measures include new EU-wide regulations on financial markets (accompanied by more radical approaches, such as the downsizing and restructuring of the banking sector under public control and governance, to be tackled at national level), as well as reform of the European Central Bank to enhance its role as lender of last resort. Equally urgent, the upcoming institutional design for a so-called 'economic government', which is to interfere with national government budgets and labour market regimes to push through public expenditure and wage cuts, must be blocked to give countries more room to breathe and, not least, for the sake of democratic legitimacy. In

addition, what is really needed for monetary union is a strategic agreement on solidarity – or transfer – mechanisms (technically based on eurobonds) between richer and poorer EU countries, and a democratic institutional foundation for this supranational decision-making process. Other than currently designed at EU level, the Eurozone needs a permanent mechanism whereby current account surpluses produced in some countries can be invested in strategically useful projects in countries with current account deficits, geared to fostering sustainable development potential. More generally, given the devastating results of the hitherto dominant single-market approach, reforms of the European treaties must establish the long-needed rebalancing of economic and social rights in order to put more emphasis on the reduction of inequality and to pave the way for more sustainable models of socio-economic development.

This perspective is ‘multi-layered’ due to the simple fact that national governments must be pushed in this direction by domestic social movements. However, there is more than this to the national ‘layer’. Annamaria Simonazzi, discussing the future fate of the euro, raises a twofold question: ‘First, is there a common interest linking surplus and deficit countries and capable of supporting a commonality of policies? ... Second, are there reforms that the southern countries should implement on their own in order to make the common currency a viable policy for them, besides reforms/policies that require a common design?’ She concludes with a bold statement that is rather uncommon among non-mainstream observers: ‘Only once we have done our homework can we seek, and demand, Europe’s help.’

The punchline of this argument is that the same applies to allegedly ‘healthier’ countries in general, and for Germany in particular. With one major difference: institutional reforms within Germany would not merely be helpful, but crucial for the success of other countries. The problem that Germany poses for the EU, and most dramatically for the Eurozone, goes beyond ill-advised policy approaches imposed on other countries. The core problem is the weakening and partial dismantling of institutions over the past ten to fifteen years which, in earlier decades, provided for a combination of economic success with a – by capitalist standards – high level of social equity. As spelled out in the chapter on Germany, it is this process of dismantling which is behind average-wage stagnation in Germany and the consecutive soaring current account

surplus with the Eurozone, which obstructs economic and social development in many other Eurozone countries. Thus, curing Europe requires political *and* institutional reforms in Germany, allowing for greater equity both within and beyond Germany. As argued in the Germany chapter, both the economy and society of this country have great potential to put this into practice. For the time being, however, this potential is not being utilised, to Europe's considerable harm. This failure impacts not just on the economies of other countries, but equally on the leeway of trade unions and other movements in society calling for alternatives to austerity and a resurrected neoliberalism.

This is what makes the 'multi-layered' and 'homework' concepts so important. There will be no European reform agenda unless each country does its own homework. Equally, without a new European reform agenda, alternative approaches in individual countries may be suffocated. This is a complex challenge indeed.

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From one crisis to another: the Swedish model in turbulent times revisited

Dominique Anxo

1. Introduction

In the mid-2000s, my colleague Harald Niklasson and I published an article, 'The Swedish Model in Turbulent Times', retracing the main developments of the Swedish model since its inception in the early 1950s up to the early 2000s (Anxo and Niklasson 2006). Our main conclusion was that, at the turn of the century, the Swedish model appeared *more* in line with the core components of the original Swedish model¹ than during the decades 1970–1980, which constituted, in our views, a clear deviation. During the 1990s, the economic policy modifications towards more restrictive and anti-inflationary macro-economic policies, the re-orientation of active labour market policies towards supply-oriented measures and the structural reforms undertaken in wage formation, tax and social protection systems suggested a revival of the Swedish model. After a period of turbulence related to the early 1990s economic crisis, the Swedish economy underwent particularly favourable economic development. Up to the current global recession, unemployment oscillated between 5 and 6 per cent, inflation was curbed and current account and public finances were restored.

1. Namely, a macroeconomic policy combining full employment and price stability, a centralised and coordinated wage bargaining system and the application of a wage norm, the so-called 'solidaristic' wage policy based on fairness (same wage for the same job independently of the profitability of the firm/industry) and efficiency (that is, fostering rationalisation at the company level and promoting productivity-enhancing structural changes through closure of unproductive plants). Last but not least the implementation of an ambitious countercyclical Active Labour Market Policy (ALMP) favouring occupational and geographical mobility. Low unemployment and full employment are to be secured mainly by supply-oriented ALMP programmes favouring a reallocation of the labour force from the declining parts of the economy to the expanding ones.

Although the re-orientation of macroeconomic and employment policy during this period might explain the ‘Swedish success story’, the modifications in Swedish industrial relations – in particular, the clear tendency to re-coordinate wage bargaining – without doubt played a vital role in the Swedish recovery. These new developments reflected a desire on both sides of industry to re-coordinate collective bargaining at industry level and restore the leading role of the traded good sectors in wage formation. The tendency towards a re-coordination of collective bargaining co-existed with a marked tendency to the decentralisation and individualisation of wage setting and working conditions.

We also claimed that strong trade union organisations and high union density at company level ensured the implementation of negotiated forms of individualisation and differentiation (*negotiated flexibility*). In our view, these tendencies should not be interpreted as a weakening of the Swedish collective bargaining tradition, but rather as a recomposition and adaptation of the Swedish model of industrial relations in the face of the major transformations of work organisation and production processes over recent decades. In our view, these developments did not call into question the basis of the Swedish model, namely a strong contractual tradition based on the existence of powerful social partners who enjoy considerable autonomy from the public authorities, but instead reflected a transition and adjustment of the Swedish model to the new challenges posed by post-industrial societies.

Also during this period, the various reforms of the Swedish social protection system essentially took the form of a temporary reduction of income compensation and, perhaps with the exception of the fundamental restructuring of the pension system, left the architecture of the Swedish welfare state system almost intact. The Swedish social protection system remained, by international standards, clearly universal and inclusive in nature and still enjoyed a high level of across-the-board political and public support. The structural reforms undertaken in the tax and benefit system – in particular, the reshaping of the pension system and the tax reform initiated in the early 1990s aimed at strengthening work incentives and fostering investment in human capital – was also clearly in line with the general philosophy of the original Swedish model favouring the ‘work first line’, integrative transitions across the life course instead of passive support and social exclusion.

Last but not least, the third main element of the Swedish model, the extensive use of active labour market policy (ALMP) – that is, the overall *policy of activation* – still occupied a central role in Swedish stabilisation policy. Its re-orientation towards a supply-oriented policy (occupational and geographical mobility, active search programmes, labour market training and so on) in many respects appears to be in accordance with the strategy initiated in the 1950s.

Since the publication of the article in question, two major events have occurred in Sweden that could cast doubt on our optimistic view of a renaissance of the Swedish model. First, the Social Democratic Party lost power and a conservative-liberal coalition government took office in September 2006. The same political coalition was re-elected at the last parliamentary election in September 2010. During its first term of office, the new government conducted several neoliberal policy reforms, concerning among other things the tax and social protection systems, as well as reforms aimed at opening up public welfare services (health care, elderly care, social services and education) to competition. Second, in early autumn 2008, the global economic recession hit Sweden severely and some aspects of the macroeconomic policy implemented might also be interpreted as a departure from the original model.

The present chapter is structured as follows: after a description of the major policy developments since 2006 and their potential impacts during the current crisis we analyse the policy strategy adopted, and identify the groups particularly affected by the crisis. Finally, Section 4 reflects on the potential impact of the Great Recession on the Swedish model and economy.

2. Development of the Swedish model prior to the crisis

The several structural reforms undertaken by the current government during its first term of office (2006–2010) were aimed principally at increasing labour utilisation in the long run, through essentially supply-oriented measures, such as tax cuts and reforms of the social protection system (unemployment benefit and sickness insurance). Several tax reforms were conducted aimed at reducing the tax wedge and increasing labour supply at both the extensive and intensive margins. The

inheritance and wealth taxes were abolished in 2005 and 2007, respectively. The corporate tax rate was reduced,² as was the total levy of social security contributions. Reforms of income tax have also been implemented gradually over the past five years. The most important tax reform in this context was the introduction of a system of in-work tax credits aimed at strengthening work incentives for low-income earners and a reduction of marginal tax for high income earners, both reforms entailing a reduction of marginal tax of around 2–3 percentage points.

Other important structural reforms concern the social protection system, namely unemployment insurance (stricter eligibility rules and lowering of benefits), as well as sickness insurance (more stringent rules, increased supervision and monitoring of a person's capacity to work). A new *unemployment insurance system* took effect in 2007. Eligibility for unemployment benefits after the reform was based on the past 12 months' earnings instead of the past six months. The reform also implied a significant diminution in the generosity of the Swedish unemployment insurance system, the income replacement rate being reduced from 80 per cent to 70 per cent after 200 days of unemployment. Furthermore, the maximum duration for receiving unemployment benefit was reduced to 300 days (450 days for unemployed people with children). The maximum daily benefit was lowered from SEK 730 to SEK 680.³ Altogether, this implies that the benefit level decreased by around 3 percentage points.

Furthermore, the right for a job seeker to restrict their search during the first 100 days to jobs according to their formal qualifications and vicinity was abolished. While these structural reforms might have increased 'work incentives' and job search intensity⁴ and might have reduced unemployment duration it should be stressed that this reform in itself does not improve the employability of vulnerable groups in the labour market and is also critically dependent on the development of labour demand for these groups. We may also contest that such a

2. From 28 per cent to 26.3 per cent.

3. 1 SEK= 0.11 euro.

4. A study conducted by the National Institute for Economic Research, NIER (2010), shows that the gradual introduction of income tax credits and the various reforms of the social protection system (unemployment and sickness insurance) between 2006 and 2010 decreased the total marginal tax effect by almost 5 percentage points. According to the same study, the so-called threshold effect (that is, the net increase in income due to taking a job) has also increased significantly.

reform – in particular the abolition of the right of job seekers to restrict their search to jobs in accordance with their formal qualifications and vicinity – may lead to more efficient resource allocation in the economy, in particular in a period of reduced labour demand.

The second major reform concerns modifications in the financing of the unemployment insurance system: the contributions of the various Unemployment Funds administered by the trade unions (the Ghent system⁵) were, after this reform, differentiated according to the unemployment level in the sector/industry concerned. In other words, a system of experience rating was introduced, individual unemployment insurance contributions being raised or lowered depending on whether unemployment increases or decreases in an industry. This reform entailed a large increase in individual contributions; in some cases, individual unemployment insurance fees tripled. The consequence was both a large decrease in union membership and a dramatic decline in the number of dependent employees covered by the unemployment insurance system: around 500,000 employees left the unemployment insurance system between 2007 and 2008. The most frequent reason for leaving the unemployment insurance funds was financial strain due to the rise in individual fees. The drop in membership was particularly severe in hotels and restaurants, retail and transport, as well as among municipal workers (see Eliasson 2008). Between 2006 and 2009, union density declined by 7 percentage points for blue-collar workers and by 7 percentage for white-collar workers⁶ (see Kjellberg 2010).

Obviously, the main objective of the government with this reform was to indirectly influence the outcome of wage bargaining by weakening the bargaining power of trade unions and therefore to induce wage restraint. The modification of the financing of unemployment insurance and the corresponding diminution of the number of persons covered by it meant that a large number of wage-earners, in particular low-paid/low-skilled employees with unstable employment conditions, lacked sufficient protection in case of unemployment – a potentially major problem

5. The Swedish public unemployment insurance system is regulated and subsidised by the state, but is administered by the trade unions' unemployment insurance funds (Ghent system).

6. From 77 to 70 per cent for blue-collar workers and from 77 to 72 per cent for white-collar workers.

during the current recession. In other words, there are strong reasons to believe that the 2008 recession increased the number of social benefit recipients among individuals not covered or entitled to unemployment insurance, increased income inequalities (see next section) and amplified the risk of social exclusion for vulnerable groups. On the other hand, the increase of unemployment risk in connection to the global crisis has partly reversed the negative trends in unemployment insurance fund membership and also in union density. It should also be stressed that, despite the decline of union membership, Swedish union density remains high by international standards (70 per cent) and the coverage rate of collective bargaining is still around 90 per cent. In this sense it can be said that the Swedish model of industrial relations to date has been only marginally affected by these reforms, implying that the bulk of labour market regulations, working conditions and wage setting in Sweden will continue to be determined and regulated by collective agreements.

The Swedish model has been based on a strong political commitment to the goal of full employment. Despite the current political rhetoric, we argue that the policy developments testify to a weakening of this commitment with a clear re-orientation of macroeconomic policy towards price stability and budget balance. Employment rates are still clearly below their early 1990s level and unemployment rates are also significantly above the rates prevailing during the 1970s–1980s. True, the decline of employment rates since the early 1990s also reflects major investment in education and a general trend toward a postponement of entry into the labour market. However, compared to other EU Member States, such as Austria and Germany, part of the transition from school to work remains problematic in Sweden, with comparatively high youth unemployment. If Sweden might be classified as ‘no country for young men/women’ (to modify Yeats), on the other hand it is a relatively good country for old men (women), with the highest employment rates among senior workers in the EU.

3. Impact of the crisis on the Swedish economy and model

In the wake of the global financial crisis, the Swedish economy started to deteriorate rapidly in the second half of 2008. In 2009, Sweden’s

GDP decreased by 5.1 per cent, the worst deterioration since the Second World War. With the severe drop in output and aggregate demand, employment declined sharply. Between 2007 and 2009, employment decreased by more than 100,000, while the unemployment rate increased from 5.9 per cent to 8.4 per cent. The fall in output and employment was particularly marked in manufacturing, with decreases of 25 and 20 per cent, respectively, while employment increased by almost 10 per cent in the private service sector and in construction. Employment also declined significantly in the female-dominated public sector, in particular at the municipality and county level, which are responsible for social services, health and education. The recession led to a reduction of tax revenues for local authorities due to the sharp increase of unemployment, local plant closures and the overall reduction of economic growth. In a first phase, this situation led to severe budget cuts at the local level and a decline in employment, in particular among public employees on short-term contracts. With regard to Swedish manufacturing, the fall in employment was particularly marked in export-oriented industries.

3.1 Policy responses: macroeconomic and labour market policy

In the face of the drastic worsening of the economic situation, as well as the growing awareness that Sweden will experience a much more dramatic drop in output and employment, the government took financial and fiscal stimuli measures at the end of 2008. In particular, extensive investments in the maintenance and operation of the road and rail networks were decided on. As far as the crisis of the financial system is concerned, the government launched a guarantee programme, aimed at securing the medium-term borrowing of banks and mortgage institutions and lowering the cost of borrowing for households and companies. In order to stimulate activity and maintain labour demand in the construction sector, work in the form of repairs, maintenance and improvement of one-family houses and tenant housing were made tax deductible. During 2009–2010, the government announced further countercyclical expansive fiscal measures to combat the crisis. These new fiscal measures covered mainly two areas: increased government grants to municipalities and county councils and more resources for active labour market policy. In September 2009, the government decided on a further increase of SEK 10 billion in the central government

grant to municipalities and county councils in 2010, as well as further investment in infrastructure (SEK 1 billion) in order to maintain and secure employment in the public sector.

As far as tax policy is concerned, the government introduced a fourth step in the abovementioned in-work tax credit (SEK 10 billion), a reduction in social security contributions for the self-employed, a further reduction in income taxes for low income pensioners and an increase in housing benefit for the long-term sick and the long-term unemployed. In order to limit the negative impact on poverty and social exclusion of the 2007 unemployment insurance reform in July 2009 the government decided on a reduction in individual unemployment contributions. The government also amended membership requirements temporarily so that members of an unemployment insurance fund in 2009 would be able to count one month extra for each month of membership in 2009. Another change introduced was that unemployment contributions were again tax deductible for employed members.

Since the late 1950s, active labour market policy (ALMP) has played a vital role in Swedish stabilisation policies. The preference for the principle of employment promotion (work-first principle) has always predominated over benefit options for the unemployed. In contrast to the 1990s crisis, when the bulk of counter-cyclical measures essentially took the form of an increase in the number of participants in various active labour market policy programmes, the Swedish government relied to a greater extent on expansionary fiscal and monetary policy to counteract the current economic recession. It is also clear that, in comparison to the 1990s crisis, the room for manoeuvre in which to conduct a more expansive macroeconomic policy was greater than previously, due to healthier public finances at the start of the economic downturn. Regarding active labour market policy measures, the volume of participants in the various ALMP programmes was gradually increased, but never attained the number of participants enrolled during the last severe recession in the early 1990s. The difference concerns not only the number of participants, but also the composition of ALMP measures. Compared to the previous crisis, the current government has focused more on labour supply-oriented and matching measures (job search assistance, coaching) and/or work experience and trainee schemes. The number of participants in traditional labour market training has also slightly increased, but much

less than in the previous recession. All in all, the number of participants in labour market policy programmes has increased but, as already mentioned, less than during the previous economic crisis. It should also be noted that public sector job creation has not been used in connection with the crisis, but the increase of central government grants to local governments has certainly had an effect in limiting the fall of employment in the female-dominated public sector.

3.2 Employment adjustment, wage setting and income inequalities

Traditionally and in line with the core elements of the Swedish model, economic downturns and structural changes have seldom been accompanied by measures aimed at maintaining the level of employment. In contrast to other European Member States, such as France or Germany, public policies aimed at reducing working time (work sharing) or facilitating temporary layoffs have not been favoured in Sweden. In the early phase of the recession, employment adjustments therefore essentially took the form of external numerical flexibility, in particular a large reduction in the number of agency workers and temporary contracts. The employment decline was also particularly dramatic among low educated and low skilled workers, while employment among employees with a high level of education was only slightly affected (employment even increased among high skilled employees). Youth unemployment, as well as unemployment among non-natives, is more sensitive to fluctuations in the business cycle and the employment prospects of young people and foreign born people have worsened significantly since the end of 2008. In the fourth quarter of 2009, youth unemployment rates reached a maximum of 30 per cent and those for foreign-born people 16.4 per cent (compared to 7.8 per cent for natives). The dramatic increase in youth unemployment might be ascribed to several factors: first, a significant increase in the youth labour supply, in other words, a relatively larger cohort of young people entering the labour market when the recession started; second, the incidence of temporary contracts is high among young people; and third, the Swedish Employment Protection Act, more specifically, the application of the seniority principle (last in, first out) favours workers with long seniority in the redundancy process. While the labour supply of people with an immigrant background was unchanged, the increase

of unemployment among non-natives is also related to their weak attachment in the Swedish labour market (higher incidence of temporary contracts, lower work experience and concentration in the low skilled segment of manufacturing industry and the service sector).

As far as gender is concerned, the relatively stronger impact of the crisis on male unemployment is related to the abovementioned decline of employment in the male-dominated export-oriented manufacturing sector, but compared to the previous crisis (1993), the gender gap in unemployment has remained much lower. There are strong reasons to believe that this is related to the more rapid decline in employment in the public sector at the local and regional levels due to severe budget cuts, despite the additional appropriations to local government by the Swedish government. Regarding older workers, Swedish companies seem to have used early retirement to accommodate the recession much less than in previous economic downturns. The employment rate of senior workers (55–64 years of age) has, to date, remained almost unchanged, while the unemployment rate increased only slightly, from 3.2 per cent in 2008 to 5.2 per cent in 2009.

As far as wage setting and wage developments are concerned, experience from the deep economic crisis of the early 1990s shows that wage moderation characterised wage developments during the second half of the 1990s and early 2000s. There were therefore strong reasons to expect that, in the wake of the current severe economic and financial crisis, wage agreements would also be concluded to preserve employment stability and limit further increases in unemployment. The outcome of the 2009–2011 bargaining round indicates that wage moderation has prevailed in Sweden. The resulting slowdown in the rate of increase in labour costs helped to alleviate the negative effects of the recession on output and employment and partly explain the increase in exports during the recovery.

Looking now at the development of the earnings distribution, the dispersion of disposable income has also increased in Sweden in the long run. Although Sweden belongs to the set of countries with the lowest earnings inequalities, the Gini coefficient increased by 26 per cent between 1991 and 2008, although it fell slightly between 2007 and 2009. During the current recession the reduction in disposable income has been particularly marked at the two ends of the income

distribution. Low and high earners both experienced a significant decline in disposable income between 2007 and 2009. Among high earners, the decline of income might be ascribed principally to the fall in capital income related to the global financial crisis. There are good reasons to believe that the deterioration among low earners might be ascribed to the conjunction of several factors: the increase in unemployment, particularly among low skilled and low paid workers, the dramatic increase in youth unemployment (new entrants into the labour market not covered by the unemployment insurance system), and the abovementioned unemployment insurance reform initiated in 2007. Although the government, as already mentioned, changed the qualification rules in 2009 and introduced a ceiling on individual contributions, there is reason to believe that a significant part of the decline in average disposable income in the first decile was a consequence of this reform.

4. Lessons and prospects three years after the Great Recession

In an international perspective, Sweden seems to have managed to overcome the current economic crisis better than many other Member States. In early 2011, the Swedish economy was in strong recovery with rapid growth (5.7 per cent in 2010), increasing employment and declining unemployment. Part of the recent improvement in the Swedish economy might be ascribed to the strong expansionary fiscal and monetary policies. Compared to previous economic downturns, Swedish economic growth during the past two years has been driven less by increases in exports than by an increase in public and private consumption, due both to increases in disposable household income⁷ and the additional appropriations to local government decided on in 2009 and 2010. Due to healthier public finances at the start of the economic downturn the room for manoeuvre for conducting a more expansionary macroeconomic policy was greater than during the previous recession (1993). Overall, the Swedish experience shows that

7. The increase in disposable income can be ascribed to the cuts in income tax and also the increase in some transfers, such as housing benefit for low earners.

strong public finances are essential for handling the challenges confronting fiscal policy, especially in a deep recession. While Swedish public finances have been somewhat weakened, deficits have also been limited. Against this background and in light of the recent economic recovery the needs of fiscal consolidation and excessive deficit procedure will be limited, implying that the negative impact of restrictive fiscal policy on employment in the public sector will also be limited in Sweden compared to other EU Member States. In contrast to countries with weaker industrial relations systems and unbalanced bargaining power between the two sides of industry, the specificity of the Swedish industrial relations system has also entailed a more balanced sharing of the cost of the crisis (see Anxo 2011). All in all, previous developments tend to show that the change of political majority and the economic reforms undertaken have up to now only marginally modified the core components of the Swedish model. The structural reforms of the tax and benefit systems aimed at strengthening work incentives are still clearly in line with the general philosophy of the original Swedish model favouring the 'work-first line' instead of passive support. Even if the volume of participants in ALMP programmes was lower during the current recession overall the policy of activation still plays a major role in Swedish stabilisation policy. Last but not least and despite the above-described decline of union density, the two sides of industry remain the two main actors regarding both labour market regulations and wage setting: the bargaining system remains centralised and coordinated.

Although the reforms undertaken by the current government have only marginally affected the Swedish model and if the government's macroeconomic policy has helped to absorb and limit the negative impacts of the crisis on employment and income inequalities in the short run, we cannot rule out that the long-term consequences of the crisis might be significant. Despite the abovementioned signs of recovery and a tendency for employment to increase, the overall unemployment rate remains high, at 8 per cent in the first half of 2011, a level much higher than in previous periods (1960–1991), when unemployment rates oscillated between 2 and 3 per cent. The long-term consequences of high youth unemployment and the deterioration of the labour market for people with an immigrant background also remain worrying. As shown by previous empirical evidence (See Nordström-Skans 2004) the potential scarring effects of an early period of unemployment may have a long-lasting negative influence on

subsequent employment performance and income development across the life course. Furthermore, an early period of unemployment may affect the timing of other critical transitions and events, such as the transition from school to work and the constitution of an independent household, as well as access to housing, parenthood and fertility patterns, career opportunities and wage development (see Anxo *et al.* 2010). Some recent empirical evidence (see Anxo 2011) tends also to show that we may not rule out either that the current crisis, like the deep recession of the early 1990s, implies that, in future, a growing share of Swedish companies will rely increasingly on external numerical flexibility, with a rise in the use of short-term contracts and agency workers. If this is the case, this development may worsen the duality in the labour market between insiders and outsiders, alter the conditions of entry into the labour market and delay the acquisition of a permanent and stable job. It is also clear that if Sweden fails to re-establish the conditions for a return to full employment, in particular to reduce unemployment and increase employment rates for some of the abovementioned vulnerable groups, we cannot exclude a progressive decline of the Swedish model, its coherence and the robustness of its social cohesion.

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Reinforcing neoliberalism: crisis and austerity in the UK

Damian Grimshaw and Jill Rubery

1. Introduction

The financial crisis in 2008 was to a large extent the product of the UK model of capitalism, centred around financial services, credit-led booms and deregulated markets. This increased the UK's vulnerability to the crisis, but the UK's was also protected compared to other European countries from the follow-on sovereign debt crisis, notably by its position outside the Euro area (Eurozone) and its relatively long dated government debt (which means less frequent debt resale). The changes in the UK model introduced by the coalition government elected in 2010 therefore represent at least in part a free political choice – that is, not directly dictated by the financial markets or by the European Central Bank – but they do not represent a political choice mandated by the electorate. Labour lost but the Conservatives did not win the election outright and many of the changes they have made contradict manifesto commitments. This chapter assesses the actual or planned changes in the UK model since the crisis under three headings. We first consider macroeconomic policy before and during the crisis and now in the austerity phase. Second, we look at the approach taken to welfare and third, the approach to governance and the provision of public services.

2. Macroeconomic policy, banking crisis and response

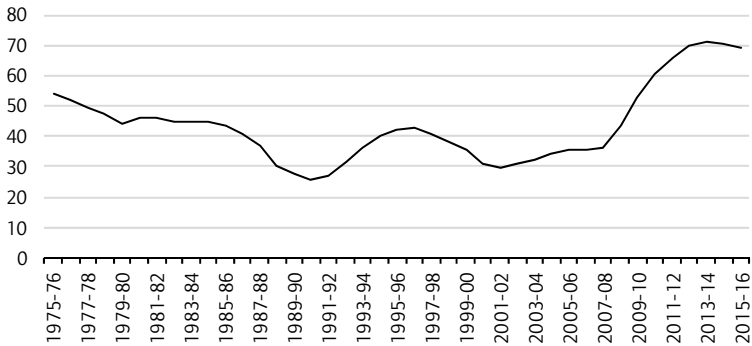
In the run up to the crisis, the UK economy was governed by a set of principles similar to the one that governs the USA. The neoliberal macroeconomic policy approach firmly rejected the Keynesianism of the 'golden age' post-war period and instead emphasised the pursuit of low inflation, limited state assistance to firms and industries, shareholder value, deregulation of product markets and liberalisation of capital flows.

At its heart, the UK model prioritised the interests of the rising class of finance capitalists. London has been an important geographical base for global finance. Moreover, Conservative and Labour governments have pandered to their needs, with the rationale that free markets prosper better with a financial class that can act unhindered to help markets grow. While the Bank of England and the Financial Services Authority repeatedly recognised the risks, they are said to have failed to appreciate the new system-wide nature of market risk (Besley and Hennessey 2010; HM Treasury 2008). The UK economy thus witnessed the well-known conditions that led to the financial crash, namely a glut of cheap credit newly made available to many low and middle-income households, a booming housing market, an under-regulated banking sector and a bubble of derivatives and futures trading among an increasingly highly paid and uncompromising financial elite (see Elliott and Atkinson 2008).

There are strong grounds therefore to agree with Crouch's (2009) assessment of UK macro policy during this period as 'privatised Keynesianism'; an increasing reliance on private rather than government debt characterised the growth model. Moreover, it conforms to a growth model that Lavoie and Stockhammer (2011) describe as pro-capital with weak wage growth, an emphasis on neoliberal economic policy and a distributional policy that favours capital over labour (for example, labour market flexibility, residual welfare policy and weakened collective employment rights). The combined result is a falling wage share, growing debt and instability.

Growing debt and instability certainly characterise the 2008–11 period. The government has used the rise in the national debt, against the backdrop of the Greek crisis, as the main rationale for its current austerity policies. National data show that debt increased over the past decade from 31 per cent of GDP to 60 per cent by 2010–11 (Figure 1) and is forecast by the independent Office for Budget Responsibility (OBR) to grow to 70 per cent by 2013–14 (Treasury 2010: Table 1.3). Nevertheless, the UK is not among the most indebted EU countries; it ranks seventh out of 25 countries, behind Greece, Italy, Belgium, Ireland, Portugal and Germany.¹

1. Eurostat data (2011), downloaded from http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-26042011-AP/EN/2-26042011-AP-EN.PDF.

Figure 1 **UK public sector net debt, percentage of GDP, 1975–2016**

Note: forecast data from 2011–12.

Source: Office for National Statistics data, OBR Fiscal supplementary tables (March 2011).

The instability of the UK model initially centred on the financial economy. September 2007 witnessed a run on the retail deposits of the Northern Rock bank. This was followed by an unprecedented £850 billion government bailout of the industry,² increasing numbers of house repossessions and rising unemployment. There followed a short-lived backlash against bank executives, including a highly publicised grilling by politicians of hedge fund managers³ and widespread criticism of ‘fatcat’ bonuses in the City. However, the UK model’s neoliberal roots reasserted themselves in the policy response to public demands for stronger banking regulation. A widely anticipated government review, Project Merlin, in fact concluded by supporting the status quo; it argued against a re-regulation of the banking industry and rejected a tax on banks or on bonuses. Instead, the four largest British banks were requested merely to ensure that their 2010 bonus pool was

2. This figure includes the £76 billion purchase of shares in Royal Bank of Scotland and the Lloyds Banking Group, £200 billion of liquidity support to indemnify the Bank of England against losses incurred, up to £250 billion guarantee of wholesale borrowing by banks to strengthen liquidity, £40 billion of loans to Bradford & Bingley and the Financial Services Compensation Scheme, and £280 billion insurance cover for bank assets (*The Independent*, 04/12/09).

3. At a House of Commons Treasury Select committee, several senior hedge fund managers were questioned by Members of Parliament. One MP, John Thurso (Liberal Democrat) is reported as telling them their public image was that of ‘an opaque bunch of spivs gambling with public money’ (*The Financial Times*, 27/01/09).

lower than for 2009 (and only for their UK workforce), to agree lending targets to business (with more set aside for SMEs, also agreed by Santander bank), to link lending targets to bonus payments and to publish the pay of top earners. These have been subsequently monitored but no significant change in speculative behaviour or high pay culture has occurred.⁴ Moreover, lending to business in 2010–11 was below target, despite additional liquidity provided through the government policy of quantitative easing (QE).

The redistribution of national product in the form of the banking bailout and quantitative easing policy has occurred against a backdrop of a turnaround in government spending policy and a reversal of approach towards demand management. Up to 2010, government displayed a partial commitment to demand management, referred to as 'coarse tuning' (Clift and Tomlinson 2006) or 'constrained discretion' (Thain 2010). Interventions during 2008 through to early 2010 in six key policy areas are likely to have prevented further job losses through assisting business survival:

- (i) financial interventions (especially QE and the credit guarantee scheme);
- (ii) a temporary reduction in VAT (from 17.5 to 15.0 per cent through 2009);
- (iii) the bringing forward of capital spending (£3 billion from the 2010–11 budget);
- (iv) financial help for businesses (including relaxed tax rules for loss-making firms,⁵ government backed loans such as the Enterprise Finance Guarantee for small firms and a £750 million Strategic Investment Fund set up in April 2009);

4. Evidence includes: bank bonuses decreased by 8 per cent in 2010–11 but basic pay increased by 7 per cent, compared to an average 2 per cent for the UK workforce (*The Guardian*, 26/04/11); continued use of multi-million 'golden hellos' and salaries to banking board executives and non-board executives (High Pay Commission 2011: 31–32); and an ongoing shareholder backlash over massive bonus payments (for example, at Barclays: <http://moneyfacts.co.uk/news/in-the-papers/?id=204794>).

5. Around 60,000 companies had deferred more than £1 billion by February 2009 (Williams 2009: 11).

- (v) a new temporary Future Jobs Fund (approximately £1 billion), involving subsidies of up to £6,500 to employers who offered full-time jobs to long-term unemployed young people;⁶ and
- (vi) sustained growth in public spending (including more generous support through social protection spending, so-called 'automatic stabilisers').⁷

Figure 2 demonstrates that spending during 2008–2009 continued the upward trajectory in place since 1999. As a direct result, jobs in the public sector increased by 107,000 from early 2008 to early 2010, providing some compensation to the loss of around 980,000 jobs in the private sector.⁸ Importantly, most jobs generated in the public sector were full-time.⁹

However, from 2010, spending dropped as part of an austerity package that initially sought to eliminate the structural budget deficit by 2014–15 and to achieve a declining public sector debt by 2015–16 through a mix of spending cuts and tax rises designed in a ratio of around four to one (Treasury 2010).¹⁰ The largest immediate percentage cuts (2009–10/2010–11) were in housing and community amenities (for example, house building and street lighting) and economic affairs (for example, economic development, including financial sector interventions). From

6. Government data (<http://research.dwp.gov.uk>) suggest the Fund supported approximately 92,000 job starts during October 2009–Jan 2011.

7. Around half the increased real total managed expenditures was due to the rise in social protection spending, an additional £28 billion of the extra £61 billion spent over the two-year period (adjusted to 2009–10 price levels). The other half was largely made up of continued increases in health and education spending (£11 billion and £7 billion, respectively) plus economic affairs (additional £6 billion), the bulk of which went to enterprise and economic development (UK Treasury data).

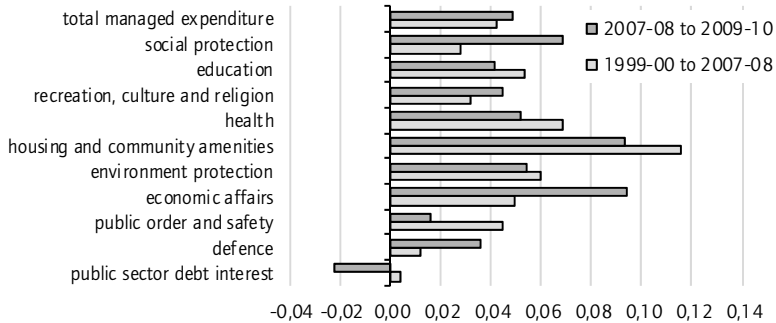
8. The public sector data exclude reclassification of financial corporation workers associated with the three nationalised banks (RBS and Lloyds in 2008 and Northern Rock in 2007). Data refer to the 24-month period from the first quarter of 2008 to the first quarter of 2010 and derive from ONS data 'Public and private sector employment' and 'Public sector employment including and excluding financial corporations' (www.statistics.gov.uk/statbase/product.asp?vlnk=8284).

9. Estimated job change during this period in the sectors of public administration and defence, education and health shows net growth of 154,000 full-time jobs and 121,000 part-time jobs (see 'Employee jobs by industry', www.statistics.gov.uk/elmr/downloads/elmr6.pdf).

10. The June budget sets out a total spending reduction of £128 billion by 2015–16, consisting of spending cuts of £99 billion and a net increase in taxes of £29 billion (Treasury 2010: table 1.1).

2010–11, however, the cumulative cuts in social protection promise to deliver the single largest category of government spending reductions.

Figure 2 **Average annual percentage change in real public expenditures for pre-recession, recession and austerity**



Source: UK Treasury data, available at http://www.hm-treasury.gov.uk/pesa2011_section2.htm.

The adverse impact of spending cuts is already proving to be damaging recovery prospects.¹¹ The government blames weak global markets but our analysis suggests that public spending cuts are causing much of the damage. Falling public sector incomes are not only depressing aggregate demand, but also causing a sequence of knock-on effects on the private sector through interlinkages of outsourcing, partnerships and subcontracting in the UK’s mixed economy. Moreover, it will prove a great shock to the UK public services (and the economy) to suddenly reverse more than a decade of average annual rises of 5 per cent in public spending that have shifted the balance in the roles of the public and private sectors in generating labour demand. Moreover, the implications of spending cuts vary significantly by region, such that areas outside London and the South East are placed at significantly higher risk.

11. The most recent OECD forecast at the time of writing predicts 0.1 per cent growth during the third quarter of 2011 and less than 0.1 per cent during the last quarter (see www.oecd.org/document/18/0,3746,en_2649_37443_20347538_1_1_1_37443,00.html).

3. Continuity in welfare reform but without the social objectives

The New Labour approach to welfare was to maintain and reinforce most of the dimensions of a neoliberal welfare and employment policy, namely a belief in work discipline, deregulated labour markets and a flat-rate benefit welfare system providing minimum and often means-tested benefits. Within this framework New Labour nevertheless made four significant changes compared to the previous Conservative policy, namely introducing a range of legal employment rights, most notably the national minimum wage, improving the level of minimum welfare benefits, increasing resources and support flowing to children (Dickens 2011) and to working parents (Waldfogel 2011) and developing, albeit at a relatively low level, some active labour market programmes for the unemployed (Bonoli 2010).

These variations on a pure neoliberal model were nevertheless strongly influenced and constrained by neoliberal ideology. With the exception of the national minimum wage, the set of legal employment rights was limited to those already agreed under the EU Social Charter and followed from the decision to give up the opt-out from the Social Charter. Once these had been agreed the UK continued its opposition to any new employment rights from the EU.¹² The higher minimum entitlements and income guarantees provided mainly through tax credit systems ran into complexities and contradictions, linked for example to overpayment problems (CAPG 2008) and hours thresholds for claimants. In some contexts they reduced work and savings incentives that are central to neoliberal policy, leading in the case of pension credits to a U-turn even before the coalition was elected.¹³ The policy of reducing poverty, particularly child poverty, was pursued without any constraints on incomes at the top end. The support for children, while

12. Three exceptions to this ban on more employment regulation included the extension of paid holiday from 20 to 28 days, the development of leave and flexible working policies for working parents and, finally, the adoption of a UK-specific regulation on temporary agency workers.

13. In response to a report into pensions (DWP 2006) New Labour recognised it could not use means-tested pension credits as its main policy to reduce pensioner poverty as these were destroying incentives to save and that higher universal pensions would be needed, as well as new savings schemes.

significant, was based on a belief that the key solution for child poverty linked to single parenthood was to move single parents into employment. The support for working parents, while providing tax credits for childcare, longer paid leaves and rights for flexible working again were based on neoliberalism and residual welfare models, involving private and high cost childcare provision, leave payments at low flat-rate levels and rights to flexible working no more than a right to request, thereby leaving decisions up to employers. The New Deal programmes for the unemployed introduced by New Labour signalled an increased government responsibility for helping the unemployed into work but New Labour retained the neoliberal doctrine that any work was better than no work, so that the ambitions for active labour market policies with regard to retraining or lifelong learning remained very underdeveloped.

In the first phase of the credit crisis the New Labour government stuck to its low benefits policy and failed to increase benefit levels, or extend coverage, unlike some other EU countries.¹⁴ It did, however, introduce new schemes for young people, particularly the youth guarantee scheme and the £1 billion Future Jobs Fund (see footnote 6). It also reinforced its support for families by increasing and bringing forward rises in child benefits and for the first time raised taxes on the higher paid – to 50 per cent for those earning more than £150,000. It also continued with policies to extend rights to request flexible working and postponed rather than cancelled the introduction of longer paid maternity leave. While recognising the increasing difficulty of finding employment for young people, it nevertheless continued with its work first policy for other groups, particularly lone parents and disability claimants and pushed ahead with privatisation of job centres, based on the principle of paying private sector organisations for success in job placements.

This description of New Labour policies before and during the crisis provides a benchmark for considering the extent of continuity and of change under the coalition government. The key area of continuity and indeed intensification is the approach to work requirements for the

14. For example, France extended coverage of unemployment insurance by reducing the minimum employment record from six to four months, extended the duration of unemployment benefits and introduced a new benefit for unemployed people with employment experience below the minimum threshold (Gautié 2011: 231).

non-employed dependent upon benefits. This includes continued and intensified pressure on lone parents and disability claimants to enter employment. Thus the maximum age of the youngest child before which lone parents can avoid pressure to enter employment has been further reduced from 7 to 5 and all disability claimants are being reassessed for fitness to work on a test which is claiming that two-thirds of claimants are fit to work but 40 per cent of appeals against the test are successful (*The Guardian*, 26.07.2011). Furthermore disability benefits have been cut and means tested. The programme of job centre privatisation has been accelerated and all active labour market programmes axed.

Five main areas of change can be identified: (i) the poor are no longer protected from the austerity package with the coalition government taking £18 billion out of the benefits budget even as unemployment continues to rise; (ii) state support for children and families is being dramatically reduced, for both the poor and the not so poor; (iii) state support for young people is being reduced and families expected to contribute more; (iv) the coalition is choosing not to interfere in household finances or the gender division of labour; and (v) labour market deregulation is back on the policy agenda.

Some of the details of these policy changes can be summarised as follows. The cuts in benefits are to be made in three main ways. The first is by uprating using a different price index, the consumer price index, that provides lower estimates of price inflation than the previously used retail price index. Second, there are to be limits put on housing benefits. Means-tested housing benefits are added to low rates of basic unemployment benefit and provide one of the main costs of the welfare system due to the inflation of housing costs in the UK as a consequence of the housing bubble. High housing costs contribute to disincentives to enter employment (Hills 2007) but the decision to cap housing benefits without any reform of the housing or rental system risks many being made homeless and required to move to cheaper areas, thus shifting the poor and unemployed out of certain areas of the south east. Third, there have been major changes made and planned to the in-work credit system with the future plan involving a universal credit system to provide a more unified benefits and credit system. While there is widespread agreement that there is a need for simplification and the removal of some high penalty thresholds that created work disincentives in New Labour's system, government

pronouncements that the new universal credit will be fairer and that no-one will lose out apply only after the benefits have been cut by £18 billion, that is, before the universal credit is introduced. Furthermore, as we discuss further below, the new system will be entirely household-based with major disadvantages for women. Families with children are the main losers – and especially lone parent families (Browne 2010, 2011) – due to changes to tax credits and the freezing of child benefits, as well as their removal from families where at least one member pays the higher rate of income tax (40 per cent on annual incomes of 41,000–175,000 euros). These changes are significant as it is estimated that without the positive flows of benefits related to children under New Labour, roughly one million more children would have been in poverty in 2007/2008 (Dickens 2011). These gains are now quickly being put into reverse.

State support for young people is also being cut in a range of areas, putting more pressure on families to support their children for longer. Many of the active labour market programmes axed by the coalition government related to young people, particularly the youth guarantee scheme. Those staying on at school from low income households have also lost the educational maintenance allowance, a means tested benefit to support young people in such circumstances continuing in education. For those entering higher education there has now been a tripling of student fees to £9,000 per annum at most institutions. This extra burden will be felt primarily in the future by this age cohort as all fees are funded upfront by the government but nevertheless the new system places a heavy extra burden on the current cohorts of young people and, potentially, their families. Young people are also a major target of the housing benefits cuts, with the age at which someone can claim for independent accommodation instead of shared housing raised from age 25 to age 35. This is expected to displace at least 60,000 young adults who claim housing benefits, to which the government minister responsible responded that they should consider moving in with their parents (Shelter 2011).

The change of approach towards gender relations is clearly signalled in the briefing documents that have been prepared for the new universal credit (DWP 2011a, b). The new credit is requiring the government to address its attitude towards household-based tax and benefit systems. There has been a long standing campaign, supported by research evidence (for example, Sung and Bennett 2007), in the UK to ensure that

benefits that relate to children are normally paid to the mother. However, in a marked departure from the previous policy the government has taken the line that while there will be a single recipient of the household benefit for each household, it argues that, 'making decisions over household finances and budgeting in the most appropriate way to meet family needs is best done by the family itself. It has been suggested that Government interference in household budgeting arguably undermines individual responsibility' (DWP 2011a). This approach is paving the way for a major switch of resources from the (female) purse to the (male) wallet. The second issue is the impact of the new system on work incentives for second income earners. Again, the government explicitly states that in its new policy 'incentives for first earners have been given priority over second earners' (DWP 2011b). Over 2 million potential or existing second income earners will see a rise in their participation tax rate from a range of 30–33 per cent to 45–65 per cent. The government anticipates a decrease in the number of second earners, arguing that this will reflect positive work–life balance choices. But it does not admit that most second earners are women. Thus fewer second earners will represent fewer women with access to independent income from employment. Moreover, it fails to understand the gender dynamics: reduced employment among second earners today will reduce the likelihood of employment participation tomorrow among those who become lone parents following the break-up of families (WBG 2011).

This policy change coincides with major cutbacks in the already limited support for childcare and a decision to treat issues of childcare and women's employment as an entirely private and family-based decision area. The only positive policy in this area is a consultation on whether to allow fathers more access to parental leave, although because this will be on a low flat-rate benefit basis at best the likelihood of it being taken up by fathers would be low.

As already noted, New Labour did very little to restore collective employment regulation but did provide some new legal employment rights, the most important of which were the minimum wage and the legal entitlement to paid holidays, which increased from zero to 20 and then to 28 working days under Labour's watch, with significant positive effects, especially for part-time workers. Many of these changes either cannot be wound back, as they are underpinned by EU law, or have so far been left alone – for example, the national minimum wage is in place

even if only rising at a low rate – due to their popularity. Nevertheless some changes have been put on the agenda, including extending the period before one can claim unfair dismissal from one to two years, ending pay protection for newly hired workers under public sector outsourcing and seeking to end it also for transferred public sector workers, although EU law may prevent this policy being enacted. There is talk of ‘an employers’ charter’ and a bonfire of regulations, especially for small firms, but the final outcome is not clear as most changes are currently out for consultation rather than ready to enter the statute books.

4. Public sector, governance and the ‘Big Society’

So-called modernisation of public services under New Labour involved the following key policies and practices:

- (i) the promotion of outsourcing through the Best Value framework which allowed for some consideration of quality in choice of contractor but did not allow for a preference for public sector providers;
- (ii) the fragmentation of the public sector through the formation of quasi-independent schools and hospitals with separate funding and accountability, with the dual objectives of reducing local government control over education and limiting the integration of the health service in order to allow for more private capital and competition;
- (iii) the adoption of a choice agenda for public services that stressed the needs of the individual user; and
- (iv) the establishment of a wide ranging set of targets, quality controls, regulations and audits of public bodies to increase central government control over the increasingly fragmented public services.

All but the fourth policy principle have been taken up and developed to an extreme level by the coalition government. However, it is the absence of a national policy and national accountability system, coupled with the extension of competition and fragmentation that perhaps heralds a major step change in the role of the state in the UK. Taylor-Gooby and Stoker (2011) argue that the coalition is set to dismantle the ‘big state’ and its institutions so as to prevent its re-establishment by a new government of

different persuasion. Thus fragmentation is proceeding through the establishment of most schools as quasi-independent organisations outside local government control and often under a private sector sponsor. University fee arrangements have been changed not to save the public purse but in order to encourage new private suppliers to enter the market. However, a proposal to fragment the health service through commissioning led by consortiums of general practitioners, potentially supported by private health organisations, has had to be partially rethought because of widespread objections to the breaking up of the health service. The fragmentation extends to many new areas, such as local planning which is to be taken out of local government control and placed in the hands of local unelected communities and groups. This fragmentation is justified ideologically under the slogan of 'the Big Society', which implies that local groups, charities and volunteers should take over responsibility for what have been regarded as key state functions and state responsibilities. This approach can thus be seen as in conflict with the centralising tendencies and target-driven philosophy of New Labour (Humphrey 2003) and in line with this notion of local responsibilities and the ending of the 'big state'. The policy is to rid society of targets and auditing, to free up local communities and the like to respond to the new 'Big Society' agenda. The policy is deliberately vague, particularly with regard to where accountability lies for these proposed new modes of governance.

The important context for this change is the major cutbacks to public expenditure in the austerity packages which are having a significant negative impact on the third sector. This has fostered a high level of scepticism towards the notion of the Big Society replacing the role of the state. One of the major consequences of the Big Society reform along with the cutbacks in public expenditure is the opening up of the social model towards even wider regional disparities. Not only have the cuts in expenditure been disproportionately targeted on the poorer or more deprived regions but these are also the areas where the community has less capacity to respond to calls for more volunteering as alternatives to state provision.¹⁵ The Conservative heartlands have been both more

15. McCulloch *et al.* (2011) find that although volunteering is related to social capital and trust in an area, once deprivation is controlled for this relationship is no longer significant, suggesting that there is very limited capacity for any deprived areas to transform their neighbourhoods through the Big Society agenda.

protected from the cuts and have more capacity to engage in the types of activity mooted under the Big Society slogan.

What still remains unclear is whether either the press or the electorate is willing to allow the state to abdicate responsibility for areas of public service. The dismantling of state-based institutions such as local government that previously could be held accountable at local level may in fact result in central government being taken more to task for failings in public services. This already occurred when a major care home provider tipped towards bankruptcy and the central government, which has no direct responsibility for social care, felt obliged to give nationwide guarantees that no elderly resident would be left without a suitable care home place.

4. Conclusions

It is three years since the recession and the UK, like several other EU countries, is gripped by the politics of austerity and debt with severe consequences for large segments of the workforce and other groups outside formal employment, including the unemployed, lone parents outside the labour market and pensioners. The UK case is particular, however, on two counts. First, it entered the recession with a strongly neoliberal socio-economic model that set strong constraints on the types of policy responses available. The then New Labour government had somewhat modified the UK neoliberal approach by strengthening the commitment to public provision of services through enhanced expenditure, which continued throughout the recession, introducing a new statutory national minimum wage and opting in to EU directives, both of which provided important floors to the flexible labour market in a context of crisis. But the range of policy responses during the recession was limited, with few examples of social partner agreements, for example, no adjustments to welfare entitlements for the increased flows of job-seekers made redundant and only partial efforts to support business investments and expenditures as aggregate demand fell. The second particularity of the UK experience is the radical shift in approach to the role of the state and the shelving of a policy concern for poverty in the immediate aftermath of the recession. It is therefore relatively difficult in the case of the UK to distinguish the role of macroeconomic policy as opposed to anti-statist political ideology in driving the policy approach during the austerity crisis. The principles of

neoliberalism, while undoubtedly a cause of the recession and a reason for the slow recovery, are therefore witnessing a remarkable renaissance in the UK with a resurgence of voices and opinions from free market economists and policy institutes that were last taken seriously under Margaret Thatcher's government. The withdrawal of central government in favour of voluntary groups or, more realistically, the private sector in the governance of many areas of public life, the emphasis on spending cuts over tax rises as the means to cut the deficit and the very speed of change all add up to a reinforcing of neoliberalism which promises to generate adverse consequences for indicators of poverty and inequality. The slow jobs recovery, difficult income conditions of the long-term unemployed, questions over how households manage their reduced welfare entitlements and evident problems experienced by young people all point to an urgent need for a radically different programme of policy actions. There is an accumulation of evidence from respected academics and the main independent policy institutes that the coalition government's policy programme is causing unnecessary pain and hardship among the most vulnerable groups of the population. Trade unions can give voice to many of the social and economic problems but for this to gather momentum in the UK's weak collectivist model a wider political alliance is needed to stop the current juggernaut of neoliberal policy reforms.

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After the party's over: the Irish employment model and the paradoxes of non-learning

James Wickham

1. Introduction

Until 2008 Ireland was the poster boy of neoliberal politicians. With its economic growth at times reaching Asian proportions for over two decades, the so-called Celtic Tiger apparently demonstrated the veracity of liberal economic principles: global openness, low taxation and a flexible labour market. Ireland was held up as a model by the (then) UK Shadow Chancellor George Osborne as a lesson for the UK and by the President of the European Commission Manuel Barroso as a model for Europe. Today, Ireland is one of the bankrupt states of Europe, but Irish politicians like to claim that Ireland is not Greece or Portugal. That is precisely the point. Nobody ever claimed that Greece or Portugal were models for the rest of us, but the crisis in Ireland is the crisis of a success story. Logically, one would expect that the depth of the crisis would lead to a questioning of the model, but that has not happened. The Irish crisis shows how whole political systems can go into denial.

The chapter begins (Section 2) by describing the *bubble labour market* of the final years of the Celtic Tiger and its sudden collapse. Section 3 shows how the road to the crisis was prepared by four core features of the Irish model: the veto-power of Foreign Direct Investment (FDI), the financialisation of everyday life, the importance of the banking sector and, last but not least, social partnership. Section 4 outlines the changes that have occurred so far in the employment system during the crisis. The chapter concludes with the paradox that the country where the relative impact of the crisis has been greatest appears to have learnt least from the experience.

2. The bubble labour market

Conventional accounts of recent Irish political economy contrast a good boom with a subsequent bad bubble. The boom was export-led FDI lasting from the late 1980s through to the start of the twenty-first century, after which it was overlaid with a domestic asset-based bubble. After the slump of the early 1980s, Irish economic growth began again in the late 1980s with GDP growing both absolutely and in per capita terms through the 1990s and reaching 10.7 per cent in 2000. GDP growth continued for the first few years thereafter, reaching 6.0 per cent in 2007. This time, however, the driving force was the expansion of domestic credit leading to rapidly rising asset prices – a classic property bubble. The collapse came in 2008, when GDP contracted by 3.0 per cent and fully 7.1 per cent in 2009 (European Commission 2010).

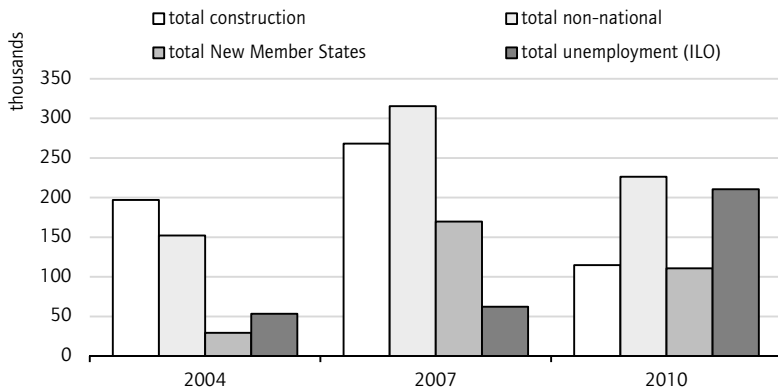
These developments were reflected in the labour market. In the mid-1980s Ireland had mass unemployment and mass emigration. In 1985, for example, unemployment stood at 16.8 per cent (in the then EU only Spain was higher, at 21.6 per cent). While GDP growth began, recovery in the labour market was initially slow. As late as 1996 the unemployment rate was still 9.9 per cent, although it fell to 5.7 per cent in 1999. The number in work was growing, but so too was the labour force: Ireland's late baby boomers of the 1970s were entering the job market, more women were now looking for work and emigrants were returning. After 2000, employment continued to grow, reaching a peak of 2.122 million in 2007, an increase of more than 50 per cent on the 1997 figure (European Commission 2010).

From about 2000, employment growth was driven largely by immigration. Between 2001 and 2007, the number of Irish people in work rose from 1.555 million to 1.660 million, an increase of just over a hundred thousand. By contrast, in the same period the number of foreigners ('non-nationals' in official parlance) at work rose from 77,000 to fully 312,000, an increase of nearly a quarter of a million! By the time of the 2006 census Poles had become the second largest group of non-national citizens in Ireland after the British, and by 2008 estimates of the total Polish population were as high as a quarter of a million. There was more Polish than Irish spoken on the streets of Dublin. This immigration was a mass labour migration within the European Union: new member state (NMS) migrants had the same employment rights and

largely the same social welfare rights as Irish citizens. Unlike illegals, they could not be threatened with deportation; unlike immigrants on work permits they were not tied to specific employers.

Total employment in construction rose to a peak of 269,900 in 2007, at which point it comprised 13.4 per cent of total employment. Within the EU only Spain had similar proportions (CSO 2008: 18). As Figure 1 shows, in just three years between 2004 and 2007 the number in work in construction rose by over a quarter. At the end of 2007, 18.3 per cent of all construction jobs were held by immigrants (13.5 per cent from NMS) and there was some truth in the popular understanding of the Irish building industry as Polish immigrants building apartment blocks for the next wave of new arrivals to inhabit. However, unlike in Spain, immigrants spread through most of the occupational structure. At the peak of employment in 2007 immigrants from the NMS accounted for 8.1 per cent of all those in work, including 20.2 per cent of all jobs in accommodation and food, 11.5 per cent of all manufacturing but also 13.9 per cent of administration and even 2.6 per cent of financial services. Indeed, despite overrepresentation in less skilled jobs, 7 per cent of all NMS immigrants in work were employed in professional and managerial occupations (CSO 2011a).

Figure 1 **Total employment and unemployment 2004–2010**



Source: Derived from CSO (2011a).

The astonishing employment growth shows how, just as Ireland had an *asset* bubble, it also had a labour market bubble. There are striking historical parallels with the booms in the new settler societies of the nineteenth century: extraordinarily rapid growth in which populations could double in ten years; 'boosterism', propaganda that involved a suspension of normal beliefs so that continued exponential growth seemed possible; and finally dramatic crashes when growth ceased and population fell (Belich 2010; Reeves *et al.* 2010). Just as in the settler booms the rapid growth of employment depended on the continued inflow of new settlers, so in a bubble labour market there is a continued inflow of new workers. The notion of a territorially bounded labour market collapses.

The apparently inexhaustible supply of labour involves a paradox. On the one hand, migrants flood in because they assume they will obtain well-paid jobs. On the other hand, this continued inflow reduces wage inflation: demand for labour rises, but so does supply. The paradox can be resolved when we realise that there are two frames of reference involved. For the migrant, the point of comparison is the wages back home (Waldinger and Lichter 2003); for the employer, the comparison is wages in the local labour market.

Bubble labour markets are flexible labour markets. Rather unusually, this flexibility suits both sides of the employment relationship. In the bubble, employers need labour and are prepared to take on almost anyone. New immigrants mean that the qualifications on offer no longer fit into the well-established categories with which employers are familiar, while employers lack the time or expertise to verify qualifications. At the same time, because there appears to be an inexhaustible supply of the right people, employers face little pressure to develop labour-saving innovation or alternative employment strategies.

3. Creating the bubble

This bubble was generated by four key features of the Irish socio-economic model which became more pronounced as the boom of the 1990s turned into the bubble of the mid-2000s.

First, the central role of FDI in the national growth strategy provided the overall framework for the crash. From the 1930s to the 1950s the newly independent state had pursued a policy of economic protectionism. Partly for this reason, Ireland did not share in Europe's post-Second World War reconstruction. In 1957, however, the country began abolishing import duties, creating tax benefits for exporters and aggressively pursuing foreign direct investment producing for export to the developing European market.¹ Starting initially in relatively simple assembly type manufacturing jobs, FDI has increasingly focused on high technology manufacturing (electronics, medical instrumentation, pharmaceuticals), software and financial services. In the early years foreign-owned firms came from elsewhere in Europe, including some German firms looking for a low-cost manufacturing base; slightly later these were joined by Japanese firms seeking access to the European market. Already by the 1980s the state agency then responsible for FDI, the Industrial Development Authority, had a reputation internationally as one of the most effective organisations in this area and had begun to successfully target specific sectors of potentially mobile investment, especially electronics and pharmaceuticals. Since then there have been several waves of FDI in 'high tech' sectors, and despite its size Ireland has long had one of the largest volumes of FDI within the EU (Barry 2007).

Today, far more is involved than manufacturing, of which some of the most mobile has relocated. Thus while Dell closed its Limerick plant and moved production to Poland in 2009, the company employs 2,200 in Ireland in service support, sales and research (Irish Times 2011a). FDI now includes logistics, service support and even European or regional headquarters. As of now, virtually every major US software company has a base in Ireland, including Google, whose European headquarters is in Dublin.

This investment is increasingly American. As of 2008, US affiliates directly employed 91,000 in Ireland, representing about 5 per cent of all employment in the country (Irish Times 2011b). All of this occurs against a background of the changed role of Irish politics in the USA.

1. There had been foreign (almost entirely British) ownership of manufacturing industry in the protectionist period, but this was in the very limited industry servicing the small domestic market and the extent of such ownership was legally restricted.

Irish-Americans long ago broke out of the ethnic ghetto and their entry into the US corporate elite has become an important resource for Irish economic policy. Indeed, the attraction of US investment to Ireland has become one of the most successful examples of elite diaspora politics globally.

The policy rhetoric surrounding FDI has often stressed that foreign firms would generate domestic spin-offs, so that FDI would become the motor of a more broadly based economic development. The reality is rather more complex. Especially in software, but also in medical instrumentation, a parallel indigenous industry has grown up (O'Riain 2004; Giblin 2011). These Irish firms are not necessarily direct suppliers to the foreign sector even though they share a professional and managerial labour market. These firms are also very different from traditional domestic industry, since many serve the international market from the very beginning. The combination of cheap air travel and electronic communications means that they are 'born global' (Wickham and Vecchi 2008).

The reliance on export-oriented FDI has been a leitmotif of Irish economic policy for over half a century. It rests on an almost complete national consensus and has never been seriously challenged, even by the marginal socialist and left nationalist groups. Initially, the key policy instrument was various forms of state grant to foreign companies, but these have been increasingly replaced by tax relief and then simply by the low corporate tax rate. Of course, firms' location decisions involve far more than this: English language, political stability, access to the European market, wage levels, competitiveness, all play a role. At times, rather grandiose claims have been made for the virtues of Irish education and more recently for the strength of relevant scientific research in Irish universities. Nonetheless, state policy towards FDI has paid decreasing attention to social and physical infrastructure and has focused increasingly on low corporate tax as the key incentive for FDI. This has ensured that a political conflict with other EU member states was 'pre-programmed'. Such a conflict was further promoted by the Americanisation of Irish public discourse and economic thought, the promotion of 'Boston not Berlin' as a social model and the direct and indirect influence of the Dublin American Chamber of Commerce on political decision-making.

A second key precondition for the bubble was the steadily increasing financialisation of everyday life (Froud *et al.* 2007). Central here was the new role of housing. Ireland has long had a high level of owner-occupation and this had been accentuated by the policy of selling 'council housing' (social housing) to tenants since the 1980s. Before the start of the bubble 82 per cent of all households were owner-occupiers, one of the highest levels in Europe, even though until 2000 about 50 per cent were debt free (Fahey 2003). Widespread home ownership means, by definition, an extensive property market for private homes, and this is interwoven with the development of retail financial services. Owners can of course buy and sell, but for the past decade or so Ireland has been at the forefront of the financialisation of home ownership that has characterised most of the Anglosphere. The development of financial services allows home-owners to use their property as security for further borrowing. Equally, mortgages themselves can become financial instruments, bought, sold and securitised by financial organisations. Once this process is under way, the home loses some of its distinctive emotional features, and becomes in part just another type of property. This interweaving of extensive personal home ownership with extensive mortgage credit creates a particular variety of 'residential capitalism' (Schwartz and Seabroke 2008).

Private property is thus used to generate income, whether directly (rent) or through being bought and sold; it can be used as leverage for further purchases or simply as security to enable borrowing for consumption ('the house as ATM'). What matters is not just that there is extensive private property ('lite wealth'), but that the different forms of private property are *fungible*: they can be easily bought and sold so owners can easily change the form in which their wealth is held.

The transformation of the pension system also expanded private asset ownership. Across the private sector (and in state enterprises) defined benefit schemes were increasingly replaced by defined contribution schemes, so that individuals ended up owning various financial assets from which (hopefully) they would receive their pension. The privatisation of the national telephone company was explicitly designed to further such 'people's capitalism', but unlike in the UK in the 1980s there has been no further mass privatisation of state property (Sweeney 2004).

This financialisation has two immediate consequences. For an increasing number of people, life chances are no longer determined purely by their occupation but also by their property and how they manage it. This can create new economic success, but as the Irish soon discovered, it also brings new and bigger risks.² Second, public services have to be purchased. Instead of de-commodification (Esping-Anderson 1990), welfare is re-commodified. Most Irish households now buy private health insurance in order to access privately provided health care (Burke 2009); an increasing proportion have abandoned the public sector for the private schooling of their children. Often described as late or incomplete, the Irish welfare state became a residual welfare state closer to Boston than Berlin.

This financialisation was a necessary condition for the boom to become a bubble. It made it possible for property ownership to become an obsession of large swathes of Irish society, paradoxically creating a new rental market as larger numbers of people invested (borrowed) money in 'buy to let' property. Much of this was overseas: according to one estimate, by the peak of the bubble an estimated one in ten of the Irish population owned property abroad (Guardian UK, 3 April 2011; Wickham 2006). In this Ireland was following the UK, as described by a manager of one of the largest UK estate agents:

We are the first in Europe to see property as an asset class. We use it as a substitute for pensions and now are buying overseas. (Fay Davies, Director of International Property at Jackson Stops and Staff, Financial Times, 29 October 2003)

Unfortunately such purchasers ignored the legal health warning: the value of assets can go down as well as up...

In the USA, the expansion of consumer credit occurred when real wages were stagnant; credit functioned temporarily to provide illusory growth. In Ireland, the credit expansion occurred when real wages were actually rising. Cheap credit did not compensate for no growth, as in the USA, but instead accelerated the rising consumer expenditure which wages

2. Back in the 1980s, sociologists discovered the new 'risk society' (Beck 1986); very few have noticed the return of the traditional risks of the market.

were already financing. Furthermore, both lenders and borrowers assumed that incomes would continue to rise: any pause in continuing economic growth would make the system unsustainable.

A third precondition for the bubble was the nature of the banking system. Conventional economic commentary focuses on the combination of Eurozone membership (cheap credit) and weak banking regulation. However, this ignores how the fundamental political commitment to an 'Anglo-Saxon' financial system in a liberal market economy stacked the cards against any effective banking regulation. Banks have always had a disproportionate role in the Irish economy. During the 1990s the two long established Irish banks (AIB – Allied Irish Bank and Bank of Ireland), like many other banks elsewhere in Europe, made the transition from traditional retail banks to financial services companies with increasingly competitive marketing of their financial products (Regini *et al.* 1999). Both AIB and Bank of Ireland expanded overseas, purchasing affiliates in the United States and the United Kingdom.

After the crisis of the 1980s, a key element of the national growth strategy became the promotion of the Dublin International Financial Services Centre as a location for mobile global financial services. While the low tax rate was certainly an important attraction, today it is conveniently forgotten that 'light touch regulation' was explicitly advertised as a reason for financial services companies to relocate to Ireland. This, too, made tighter regulation of the existing banks implausible. In this context, one small bank (Anglo-Irish Bank) and one building society (Irish Nationwide) could become 'rogue' institutions, aggressively expanding their loan books without any regard whatsoever for normal lending criteria. This in turn pushed the traditional institutions down the same road.

The expansion of bank lending had little to do with the foreign-owned sector and was of little relevance to indigenous enterprise; the banks' major loans were to property developers and also to private consumers. The Irish property bubble was based on an extraordinary expansion of credit. In 2002, total mortgage debt was 47.2 billion euros; at the end of 2008 it had more than trebled to 139.8 billion euros (CSO 2008: 8). This enabled large-scale building of houses and apartments, hotels and offices, many of which now stand empty. Until the building boom ended, the state finances were actually in surplus. With entry to the Eurozone,

Irish banks suddenly had access to cheap credit, which they used for increasingly irresponsibly domestic loans. When the boom collapsed, many of these loans were worthless. The cause of the current crisis is that the Irish state took responsibility not just for deposits in Irish banks, but for the banks' entire loan books. The crisis is a crisis of private debt which then became a public one. Trained to worry about state debt, nearly all Irish economists were blithely unconcerned about the expansion of private credit that lay behind the bubble.

Ireland's dominant political party, the populist Fianna Fáil, has always had close links with the building industry. Now the builders became the core of a new *indigenous* business elite, whose buccaneering business antics³ continued to inflate the bubble and whose extravagant lifestyle appeared to exemplify the new Ireland.

Paradoxically, a fourth precondition for the bubble was a key feature of the employment system itself: social partnership. Beginning with the Programme for National Recovery in 1986, a series of tripartite agreements agreed wage rates across the entire economy. Over time, the agreements covered a wider range of policy issues and included other interest groups, especially the so-called 'community sector'. This was partly stimulated by the developing European Union governance system, but also had distinctively Irish sources and features. Partnership spread out to areas beyond the workplace with 'partnership' at local community level hailed by enthusiasts as exemplifying deliberative democracy and social innovation (Sabel 1996). In parallel, there was an attempt to develop workplace or enterprise partnership: across the state sector and in a few private companies partnership committees were created which were intended to deliver mutual gains through increased productivity and better working practices (Roche and Geary 2000).

It is, of course, difficult to judge what would have happened to wages without these agreements, but national agreements probably reduced overt industrial conflict and marginally restrained wages in the private sector, while state sector wages probably increased more than they

3. Famously, Irish developers took great pleasure in buying landmark properties in London and were rumoured to have purchased the island of 'Britain' in Dubai's new artificial archipelago.

would have otherwise. The very rich undoubtedly benefitted most from the boom and above all from the bubble, but overall income inequalities in the mass of the population seem to have remained relatively constant even as incomes rose. Ireland was one of the more unequal societies of the EU15 before the boom; economic growth made everyone better off but did not seriously change relative disparities (Nolan and Maître 2007: 41). For everyone at work real wages increased. Those who could not work – or who did not want to work – also gained. Benefit levels were high by European standards (and significantly higher than in the UK); access conditions were eased; labour market activation was almost non-existent (Grubb *et al.* 2009). What mattered was cash, not public services or social infrastructure. Thus for both employers and unions reducing direct taxation was a priority, whereas improving state services was not. While union activists might bewail the ‘incorporation’ of union leadership, and these same union leaders might welcome the chance to participate, however marginally, in national policymaking, social partnership had popular support because it had apparently delivered more jobs and more money (Teague and Donaghey 2009).

Involvement in national agreements ensured that Irish trade unions were not marginalised from decision-making, as happened in Britain. While liberal commentators complained about union power, what is striking is how little partnership achieved. Most dramatically, unions were unable to achieve any right to union recognition, even though at the end of the period they were able to force the creation of the National Employment Rights Agency. Significantly, the remit of this organisation was simply to enforce existing employment legislation! Even when government funds were available, there was no shift towards labour market activation for those that remained outside the labour market. This could have been politically problematic since it would have meant challenging the dependency culture that had become widespread in deprived areas. Less explicable is the failure to tackle deficits in the education system at vocational, secondary and, especially, primary levels, or to seriously increase Ireland’s notoriously low level of childcare provision. Health expenditure certainly increased, but in the context of growing privatisation and the consolidation of a dual public/private system. In policy areas further removed from traditional union concerns the record was worse. In public transport unions merely protected their members’ short-term interests (Wickham and Latniak 2010), while tolerating a massive expansion of private transport. Significantly, the

peak of social partnership occurred at the same time as the complete collapse of spatial planning. Indeed, it is arguable that if Ireland had had effective spatial planning, the building boom would have been restrained.

Gross union membership increased, and unions made determined attempts to recruit new members from the new immigrant workforce in sectors such as construction and hotels and catering, but union membership in no way kept pace with the growth in employment. Furthermore, the crisis of the 1980s had cut a swathe through existing manufacturing employment, thus destroying one of the main heartlands of the unions. Whereas new foreign-owned companies in manufacturing in the 1970s had accepted, albeit often unwillingly, trade union membership among their employees, by the 1990s their successors were openly pursuing a non-union policy which national social partnership was powerless to prevent.

An unanticipated consequence of the boom was therefore an ever greater relative concentration of union membership within the state sector. This in turn has ensured that union members are now disproportionately female and in intermediate occupations. One aspect of the boom has been the undoubted greater efficacy of *sections* of the state administration. However, this change has been much weaker in those state services, especially education and health, where large numbers are employed. Consequently, Irish trade unions were increasingly perceived as a producers' lobby group, concerned simply to maintain their existing pay and conditions and unwilling to generate the political vision to campaign for improved services. To the extent that social partnership did not involve any substantial 'social wage', it ensured that rising wages were used to buy goods and services on the market, and was complicit in the financialisation process.⁴ Unwilling or unable to challenge the veto power of FDI, social partnership consolidated the overall framework of Irish social and economic development.

4. Given that the relationship between union membership and income is now probably u-shaped (low at the top and bottom of the income distribution).

4. The employment model in crisis

These features of the national model also contributed to the particular form of the crisis. With the end of the speculative building boom, employment in construction was decimated (Krings *et al.* 2011), falling to less than half of the 2007 peak by 2010 (see Figure 1). Employment also fell sharply in hospitality and catering, where many NMS immigrants had been employed. By contrast, employment in the export-oriented FDI sector has held up well, with job losses compensated for by the arrival of new firms.

Most immigrants during the bubble were EU citizens from the NMS. This had contradictory consequences once the bubble burst. Paradoxically, legal immigrants were more likely to be ready to leave because they had unrestricted rights of entry – unlike illegal immigrants, they could come and go as they please, and were not trapped in their new destination, fearful that if they left they might not be able to re-enter. On the other hand, because NMS immigrants had the same social security rights as Irish nationals, their entitlements to welfare support (Jobseeker's Benefit and Jobseeker's Allowance) cushioned them against the immediate need to leave Ireland when they lost their jobs. Furthermore, while very few NMS migrants ever intended to stay permanently in Ireland, a not insignificant number discovered more personal or quality of life reasons for staying on (Krings *et al.* 2009). The result was that after 2009 the number of new arrivals fell dramatically, but the decline in the NMS immigrant population was much slower. In 2010, there were still over 100,000 NMS nationals at work in Ireland, but now for the first time they had a higher unemployment rate than the host population. There has been some tightening of access to welfare benefits, especially where Family Income Supplement is paid for children not living in Ireland.⁵ Some politicians have also questioned whether NMS migrants should continue to have full access to Irish welfare rights. However, to date there has been no break with the principle that EU citizens cannot be discriminated against in the labour market and in the social security system.⁶

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5. Family Income Supplement is a welfare benefit paid to low wage employees who are supporting children: there is no requirement that the children are actually in Ireland, although the claimant's 'habitual residence' must be in Ireland.
 6. Like other EU states, Ireland has delayed access to the Irish labour market for Bulgarian and Romanian citizens.

With the crisis unemployment has soared, especially amongst young men. By early 2011 fully 32.6 per cent of all males aged 20–24 were unemployed (ILO definition) and long-term unemployment was also rising (CSO 2011). The immediate impact on women was somewhat less. Although there has been a slight increase in the number of women apparently withdrawing from the labour market altogether, most women have not only stayed at work but the pressure on household budgets means that their earnings are more important than before. However, the gender situation itself is unstable: cuts in state employment will impact most on women employed in education and health, while cuts in services (especially child support) will push back caring work into the household – and onto women.

More generally, a flexible labour market and a ‘buy not make’ approach to skill creation ensured that firms made little attempt to hoard labour through the crisis – in obvious contrast to Germany. At the same time, skilled immigration continues to be crucial for those sectors which are seen as decisive for economic growth. Despite the crisis, the IT industry has repeatedly complained of significant skill shortages; in summer 2011 Google was complaining that it could not find suitable Irish recruits.

The distinctive feature of the Irish crisis is that it is above all a banking crisis. Despite the rhetoric of the ‘bloated state’ beloved of liberal commentators, before the crisis hit the Irish state was running a fiscal surplus. With the crisis, state revenue collapsed, not least because the policy obsession with low income tax had meant that the state’s tax revenue was increasingly derived from property transaction taxes. While state sector wages and salaries are still relatively high by European standards, the absolute size of state employment is not. The immediate cause of the state’s financial crisis was the unprecedented acceptance by the state of responsibility not only for the deposits in Irish banks but for their entire loans. This dramatic example of ‘socialism for the rich’ (the privatisation of profits, the socialisation of losses) led directly to the IMF–EU bail out in November 2010.

The crisis has actually consolidated the importance of FDI. Almost entirely because of the foreign-owned sector, Irish exports are now (2011) again at pre-crisis levels, employment in FDI firms is probably at least as high. If anything, the dependency of FDI employment on the

low tax rate has also grown, because US firms seem to increasingly route their global profits through their Irish subsidiaries. Certainly in 2008 (the latest year for which figures are available), US firms in Ireland posted per Irish employee a multiple of the profits they declared for their employees elsewhere in Europe.

With the crisis, mass unemployment has returned. In this sense, the current crisis is a repeat of that of the 1980s. In some terms the situation is not as bad as the 1980s: unemployment has peaked at just under 15 per cent, whereas it came close to 20 per cent in the last crisis. Furthermore, welfare benefit levels have only been marginally reduced, and although there has been some tightening of benefit conditions, in direct income terms the lowest income groups have *probably* lost *relatively* little, although specific vulnerable groups have been hit by state cutbacks (for example, services for children with disabilities, English teaching in immigrant schools).

Overall, earnings have declined. This is clearest in the state sector: pay has been reduced and a special 'pension levy' imposed even on those on short-term contracts who will never benefit from any public sector pension. Together with tax increases this meant cuts in after tax pay from 2009 of up to 25 per cent, with the impact probably greatest in the best paid groups. For those still in employment in the private sector, the impact has been more complex, varying by industry, firm and occupational group. In general those in the FDI manufacturing sector have been affected least and in a few cases wages even appear to have increased. In areas where employment has fallen most, such as construction, hospitality and retail, wages and conditions have also deteriorated sharply for those still in work (Krings *et al.* 2011).

The real novelty of the crisis is that the financialisation process of the boom and bubble has now shown its dark side. It has contributed to new forms of 'middle class' poverty:⁷ comparisons with the impact of the great inflation crisis in 1923 Weimar Germany are apt. The clearest

7. Evidence here remains anecdotal. The main Irish charity, St Vincent de Paul, reports a dramatic increase in applications from 'middle class' families. Stories abound of houses with six bedrooms and twin car ports where the heating was turned off in the winter because there was no money to pay the bills.

losers are those who purchased apartments and houses on 100 per cent mortgages at the height of the bubble. The value of residential property nationally has fallen by 41 per cent from the peak of 2007 (CSO 2011b) and most prices are still falling. As incomes fall, servicing these mortgages becomes more and more difficult, while negative equity means that selling the apartment or house is no solution. Worst hit are those who purchased on developments, especially housing estates, that are unfinished – the term ‘ghost estate’ has now become a common Irish expression. Such people now face the appalling prospect of repaying loans on property that has become almost worthless.

Unsurprisingly, in this situation emigration is increasing. The recession of the 1980s was the first time that the better educated were more likely to leave. Unlike in earlier decades, Irish social welfare benefits were then at British levels, so that the incentive for unskilled emigration was much reduced. Both permanent and temporary graduate emigration has long been normal in Irish society. For example, in a typical boom year such as 2005, over 8 per cent of Irish honours graduates were working abroad a year later (HEA 2006). Analysis of the 2001 census shows that the higher the level of education, the more likely people are to have lived outside the country (Wickham 2007). This is even more true today, and emigrants appear to be disproportionately young and well educated. However, compared to their predecessors of the 1980s, graduate emigrants today may have fewer advantages on the international labour market. Whereas then they were likely to have technical qualifications such as engineering for which there was international demand, today they are more likely to have only general arts or business degrees. They are more likely to end up working on Australian building sites than in professional jobs in Continental Europe or the United States.

The crisis marks the end of the social partnership which had been seen as a distinctive feature of the Irish model. The unions have largely lost access to government decision-making and there is no attempt from any quarter to recreate the crisis corporatism of the late 1980s. The only residue of corporatism has been an agreement between the government and the public sector unions in June 2010 in which the unions committed themselves to efficiency savings in return for a government promise of no further pay cuts (the Croke Park Agreement). Nonetheless, meeting the EU–IMF bailout terms make further cuts in public sector

pay likely, while, also as a consequence of the bailout agreement, the government proposes to reduce the statutory protection of wages and hours in some low wage sectors. The bailout terms also mandate sales of state assets, and this too will probably involve a further reduction in public sector employment.

5. Conclusion: Three years on

With exports from the FDI sector performing well, its political priority-sation remains untouched. This suppresses any worries about the very narrow base on which it now rests (a few leading US firms in pharmaceuticals, software and electronics) and probably overestimates its R&D contribution. Far from stimulating any rethink of the national development strategy, the crisis has turned the reliance on FDI into a national fetish. Bizarrely, not only the Labour Party but even the left nationalist Sinn Féin have made 'our' corporate tax rate into a symbol of national independence. While personal taxes have risen, the desirability of low personal tax rates also remains part of the national political consensus.

A socio-economic crisis which was produced by Ireland's almost pathological commitment to the priorities of Anglo-American capitalism has ended up moving Ireland closer to the United States than to the European Union. Blaming foreign 'European' bankers, cantankerous French politicians and greedy Germans has become a national response across broad swathes of political commentary. The days when the Irish political elite aspired to be model Europeans are now a distant memory.

Thus there is no sense that the crisis could stimulate any move towards collective provision in the face of collective adversity (the contrast with the creation of the British welfare state in post-1945 austerity is instructive). Instead, privatisation of pensions, education and (to some extent) health continues, while state assets are to be sold. Rather than strengthening the state, the response is to weaken it. The jettisoning of social partnership has ensured that other features of the Irish model have been consolidated. The Irish experience shows how, confronted by a cliff, lemmings will sometimes rush to fall over its edge.

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German capitalism and the European crisis: part of the solution or part of the problem?

Steffen Lehndorff

1. Introduction

Germany is riding high once again. It is true that the German economy suffered its worst slump since the founding of the Federal Republic owing to the global crisis of 2008, but the effects on its labour market were less severe than in any other EU country. The German 'employment miracle' was born and was held up for admiration all around the world. What happened next was what Chancellor Merkel had predicted early on: Germany emerged from the crisis 'stronger than before'. This second part of the success story began with particularly high growth rates from autumn 2009 onwards. But Germany's export-driven industry, on which it was based, came in for criticism within the EU and, above all, in France. Even greater consternation was caused in some countries by the attempts of German politicians to declare their model an example for the rest of the EU and in particular for the Eurozone. Ultimately, however, much of the criticism has been ineffectual: in view of the euro crisis, Germany now dominates EU affairs more than ever.

What lies behind this success story – if or to the extent that it is one? Should, and could, other countries follow Germany's example? We shall attempt to answer these questions in three steps, by outlining the changes in Germany's socio-economic model before the crisis and then during the crisis, and lastly by turning our attention to the uncertain present and future.

2. Before the crisis

At the core of what was long described as the German variant of 'coordinated' or 'Rhenish' capitalism was a combination of economic

dynamism and relatively little social inequality. Until about 20 years ago, institutions such as the industrial relations system, labour legislation and the welfare state helped the economy as a whole, as well as large swathes of society to benefit from the success of its export-oriented industry that was based on high value added and high-quality manufacturing, and reliant on 'patient capital' and skilled employees. The sudden monetary incorporation of East Germany, however, was followed by a decade and a half of thorough political and economic transformation, which in its radicalism far outstripped the adjustments to the neoliberal mainstream that took place in most other EU countries (cf. Lehndorff *et al.* 2009). As a result, the German model had a new look on the eve of the major crisis of 2008/2009: a re-energised and highly efficient export industry in an environment of increasing social and institutional disintegration and fragmentation. These contradictory circumstances are explained in more detail below, with the aim of better understanding two issues: in what way did Germany contribute to initiating the crisis, and what role did Germany play in the outbreak and persistence of the euro crisis?

2.1 Germany's special role in the Eurozone

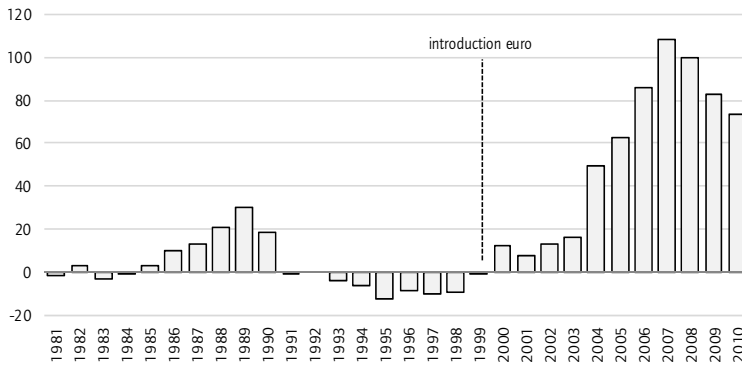
The starting point for our analysis is the weakness of wage growth in Germany: nowhere else in the EU had workers' pay risen as little as in Germany from the start of the decade until the onset of the crisis. Unit wage costs stagnated and even declined somewhat in manufacturing industry (Niechoj *et al.* 2011). This contributed to a huge increase in export surpluses in the past decade.

The export successes of German manufacturing – machine building and motor industries account for over one-third of goods exported from Germany – are of course deeply rooted in a high degree of specialisation and product quality, the service orientation of companies and their employees' skills and flexibility (Lehndorff *et al.* 2009). Nevertheless, as the Deutsche Bundesbank (2011a: 17) cautiously put it, Germany's export success in the past decade received 'an impetus from the improvement in price competitiveness'.¹ For instance, it was no

1. The European Central Bank (ECB 2011) calculates that Germany's price competitiveness compared with that of its main international trading partners grew by 16 per

accident that the remarkable rise in export surpluses coincided with the introduction of the euro (Figure 1). The elimination of the exchange rate adjustment mechanism within the currency union, with which Germany conducts approximately two-fifths of its foreign trade, means that goods-based competitiveness is linked to the rise in price competitiveness (Horn and Stephan 2005).

Figure 1 **Germany's current accounts with the Eurozone countries (€ billion)**



Source: Deutsche Bundesbank; own calculations.

The other side of this coin was the imbalance in the domestic economy: between 2001 and 2008, three-quarters of Germany's economic growth was attributable to the export surplus, whereas domestic demand contributed just one-quarter (Priewe and Rietzler 2010: 64). Thus, sluggish wage growth prevented both a transfer of the growth stimulus deriving from the export boom to the domestic market and a concomitant rise in imports, which would have enabled other countries to benefit from the export-derived growth stimulus enjoyed by German manufacturing industry (Joebges *et al.* 2010: 10). Germany's special role within the EU in this respect is reflected in GDP growth rates, in

cent between 1999 and the start of 2011 (basis: GDP deflator). The only other EMU countries with positive values are Finland (6.4 per cent), Austria (4.6 per cent) and France (3.2 per cent). The Bundesbank (2011a: 33) points out that the cost benefits gained had 'evidently been utilised partly to raise profit margins'. We shall examine this aspect in more detail below.

price levels and in disposable household income since 2001: German growth rates almost continually lay below the EU average (Table 1).

Table 1 **Real GDP growth, inflation rate and disposable household income, Germany and the EU-27, 2001–2008**
(annual growth rates in per cent)

	2001		2002		2003		2004		2005		2006		2007		2008	
	DE	EU	DE	EU	DE	EU	DE	EU	DE	EU	DE	EU	DE	EU	DE	EU
Real GDP	1.2	2.0	0.0	1.2	-0.2	1.3	1.2	2.5	0.8	2.0	3.2	3.2	2.5	2.9	1.3	0.8
Inflation	2.0	3.2	1.4	2.5	1.0	2.1	1.7	2.3	1.6	2.3	1.6	2.3	2.3	2.4	2.6	3.7
Disposable income	2.1	3.3	-0.4	1.6	0.5	1.6	0.2	1.4	0.6	1.7	1.0	1.7	-0.2	1.6	0.6	1.5

Source: OECD Country Statistical Profiles.

The imbalances expressed in these figures are sometimes discussed in Europe under the heading ‘Germany is exporting too much’. They could equally – and perhaps more aptly – be encapsulated in the statement ‘Germany is importing too little’, since the weakness of the domestic market is primarily a manifestation of the increasing inequality in the redistribution of income and capital. We shall return later to the significance of this distinction.

What lies behind the weak growth of wages in Germany, often referred to as ‘wage moderation’? Can it be said, as critics at home and abroad tend to assume, that the trade unions are being guided in their pay policy by the increase in the price competitiveness of export industry? ‘Competitive corporatism’ does of course exist (on this point see Urban in this volume), but this in turn forms part of a more complex phenomenon. The attempt to understand these issues takes us to the very heart of the upheavals in Germany’s socio-economic model.

2.2 ‘Wage moderation’ – what is it?

Anyone looking at the trend in collective agreements on wages from 2000 to 2010 will make what is perhaps a surprising discovery. Collectively agreed wages and salaries have risen most sharply in none other than metalworking and chemicals, the two sectors of industry that

are most wide open to international competition. Even though the comparatively strong and assertive trade unions in these sectors have been unable to avert an ongoing redistribution of income to the detriment of wage-earners, pay rises have more or less exhausted the so-called 'distribution-neutral' room for manoeuvre, which is defined as the sum of the inflation rate and productivity growth in the economy as a whole (Bispinck 2011). Therefore the main causes of the low average pay rises as agreed upon in collective agreements clearly lie in those sectors that are exposed to global competition only slightly or not at all: the construction industry (where wage levels are under pressure as a result of labour mobility), the retail trade and, in particular, the public sector which lags behind all the other major sectors. This focuses our attention on the *first* structural change, namely a *dismantling of the traditional architecture of German-style pattern bargaining*. The gap between labour costs in industry and services has therefore become – and increasingly so – wider than in any other EU country, meaning that a whole range of domestic inputs have become considerably cheaper for manufacturing industry (Horn *et al.* 2007).

The *second* structural change finds expression in the fact that *effective* pay rises from 2000 to 2010 lay on average almost 50 per cent below the collectively agreed rates of increase (nominally 12.7 per cent as opposed to 23.6 per cent), meaning that real per capita wages fell by 4 per cent (Bispinck 2011). The reasons for this were:

- the weakening of the trade unions: their net organisational density fell from about 30 per cent in the mid-1990s to around 20 per cent on the eve of the crisis (ICTWSS Database 2011);
- a decline in the collective bargaining coverage of firms: just over 60 per cent of German employees were still covered by sectoral or company agreements in 2009, including 50 per cent in East Germany (Ellguth and Kohaut 2008; IAB 2010);
- a systematic weakening, on the initiative of the employers' umbrella association, of the extension mechanism which permits collective agreements to be declared universally binding by the federal government (Bispinck and Schulten 2009);

- numerous local derogations from regional sectoral collective agreements since the start of the 2000s: these pay cuts and extensions of working time would have turned the system of regional sectoral agreements into an empty shell, especially in the metalworking industry, had the unions not fought this trend by improved internal coordination and mobilisation of the membership (Haipeter 2009).

Over and above these institutional changes – *thirdly* – deep cracks appeared in the very *foundations of the institutions*. Although the following changes are not specific to Germany, when taken in combination with the abovementioned institutional upheavals they reinforce the braking effect on earned incomes:

- owing to outsourcing and reorganisation of supply chains, increasingly large parts of industry have been transferred to industrial and service companies with lower labour standards;
- the privatisation of services previously supplied by the public sector has had a similar effect. Large sectors with fierce low-wage competition – for example, postal delivery – have been created in connection with the EU services directive;
- various tax reforms since 1998 have led to a substantial loss of revenue for the public purse (amounting to 2.5 per cent of GDP in 2010; Truger and Teichmann 2010). This has put a huge amount of pressure on the wages (and also the working time) of employees in the public sector.

A *fourth* deadweight on wage progression are *upheavals in the architecture of labour market regulation*, carried out since 2003 (the so-called ‘Hartz reforms’):

- The fundamental change in the unemployment insurance system (Knuth 2010), which reduced the payment of unemployment benefit to twelve months, followed by means-tested welfare payments, and compels people to accept job

offers with low skill requirements and poor labour standards, has exerted downward pressure on many parts of the labour market (Bosch and Kalina 2008; Erlinghagen 2010).²

- The *de facto* abrogation by the German government of the European directive on equal pay in temporary agency work, which included an ‘unless otherwise agreed in collective bargaining’ clause, paved the way for dumping-level collective agreements in this sector (Weinkopf and Vanselow 2008). The number of temporary workers doubled between 2000 and December 2010, reaching almost 3 per cent of all employees (BA 2011). In 2006, temporary agency staff earned on average only just over half as much per hour as standard workers (Destatis 2009).
- A strong incentive for the expansion of atypical employment came from the public subsidies for low pay and in particular from the promotion of so-called ‘mini-jobs’ with monthly wages up to € 400. Some 15 per cent of all wage-earners – most of them women – are nowadays employed exclusively in these marginal part-time jobs, and two-thirds of them earn a low hourly wage, even though a significant majority have vocational qualifications (Weinkopf 2009).

The impact of the mini-job scheme is closely related to the continued existence of the conservative welfare state, which partially forces and partially encourages women to limit their participation in working life: the lack of childcare facilities makes it difficult for many women with small children to return to work rapidly, while the tax and social security system makes the unequal distribution of earned income financially attractive for married couples (Bosch/Jansen 2010). Even though this system, rooted in the 1950s, is coming in for more and more

2. A commentator in the *Financial Times Deutschland* summarised the situation as follows: ‘Wage costs per unit of production in Germany, incredibly, fell by almost 4 per cent in the two years following the introduction of the Hartz IV measures, having risen until 2005. This is all the more bizarre in that unemployment decreased by almost a million at the same time – which according to the rules of supply and demand ought to have led to higher, not lower, pressure on pay. This can hardly be explained at all, except by the shock of the Hartz measures’ (Fricke 2010).

criticism and partial modifications are being made (such as the introduction of a Swedish-style parental allowance), its stability basically remains intact, contrasting markedly with the enthusiastic neoliberal-inspired reforms in other areas.

The combination of upheavals in Germany's labour market institutions, on the one hand, and the dogged defence of the welfare state based on a conservative gender model, on the other, is at its most blatant in the growth of the low-wage sector. The number of employees earning less than two-thirds of median pay has risen by half since the mid-1990s, accounting for 22 per cent of all employees on the eve of the crisis. What is particularly noteworthy is that only a minority of them – approximately one-fifth – are entirely lacking in vocational or academic training. The heated arguments about how to end this state of affairs have so far resulted in nothing more than the introduction of minimum wage levels in a few sectors; as yet there is no general statutory minimum wage in Germany (Bosch and Kalina 2010).

This negative wage drift is what lies behind the decline in (price-adjusted) *average* pay of all workers in the 2000s. The drop in real pay was unique in Europe and was also something new for Germany, especially during a phase of economic growth. The overall state of affairs was summed up in this way by a commentator in the *Financial Times Deutschland*: 'Hartz IV is poisoning Europe' (Münchau 2010).

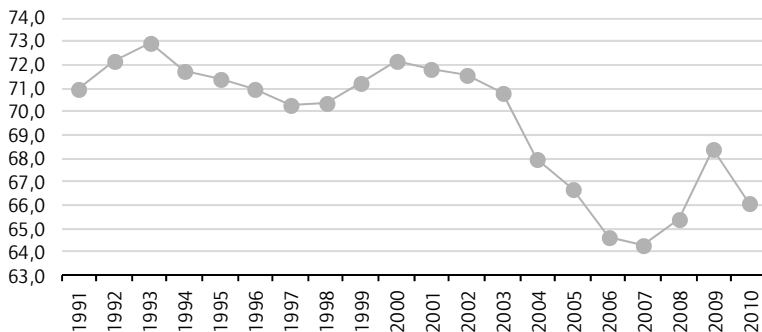
2.3 Where to put the money?

Stagnating or even declining average rates of pay contrasted with labour productivity that was rising steadily (albeit not excessively). As a result, the adjusted share of wages and salaries declined by more than 6 percentage points from the start of the decade to the eve of the crisis (Figure 2). This dynamic of mounting inequality was among the most pronounced in the EU (ILO 2010).

The gap was at its widest during the 2004–2008 growth phase, when a slight decline in net pay contrasted with a rise of roughly 20 per cent in capital income and profits (Brenke 2011). The reference made to net income indicates that changes in the primary distribution were offset by the secondary distribution to a lesser extent than had previously been

the norm. In fact, the abovementioned tax reforms had markedly reduced the top rate of income tax, as well as taxes on capital income and company profits.

Figure 2 **Wage share, Germany, 2000–2010 (percentage of GDP)**



Source: ILO (2010).

Contrary to the predictions of the main neoliberal-inspired players in the fields of economics and politics, the growing inequality did not produce any notable stimulus for investment and growth (Priewe and Rietzler 2010). This makes sense, given the stagnation on the domestic market. Furthermore, for the same reason, imports could not keep pace with exports. The statement ‘Germany is importing too little’ therefore sheds more light on the problem than the assertion ‘Germany is exporting too much’.

At the same time, the massive redistribution in Germany in favour of profits and capital income contributed significantly to the onset of the crisis (Horn *et al.* 2009), in that suitable ‘homes’ had to be sought for financial capital somewhere other than in the domestic production of goods and consumable services. And such homes were of course found: German profits and capital income played a major role in fuelling the booming financial market bubble. The SPD-led federal government had carried out numerous deregulations of the financial sector, opening the door wide for such action (Huffschmid 2010). Germany had the second-largest capital surplus in the world, after China. Unlike China, however, which rose to the position of number-one foreign creditor of the US *government*, German investors became the number-one foreign

creditors of the indebted US *private sector* (Horn 2011). German banks were also the biggest lenders to Greece, Ireland, Portugal and Spain (Bofinger 2010). The German economy was therefore not a victim of the crisis, but contributed significantly to preparing the ground for it. Or, as a commentator in the British *Guardian* put it: 'Germany blew the bubbles that popped up in the rest of Europe' (Chakraborty 2011).

These, then, were the contradictory circumstances in which German capitalism entered the crisis. But how did it manage to recover from the crisis so swiftly and even – apparently at least – to emerge from it with renewed vigour?

3. During the crisis

The collapse of the German economy from September 2009 onwards was particularly dramatic owing to its extreme dependence on exports and was surpassed only in countries where financial and property bubbles were bursting. That made the stability on Germany's labour market all the more bewildering. In a nutshell, what had happened in 2008 and 2009 was this: whereas *before* the crisis the upheaval in the German socio-economic model had contributed actively to the emergence of imbalances in the European and international economies, the stabilisation of the labour market and economy *during* the crisis was in fact attributable to a reactivation of those elements of the German model that had survived the eagerness of the neoliberals to dismantle them in previous years.

3.1 A revival of traditional strengths

The reactivation of former virtues began with the sudden – albeit temporary – abandonment of many neoliberal dogmas that had until then been standard elements of government policy. In direct contrast to all the constantly repeated tenets, extensive stimulus packages were introduced virtually overnight. The 2009 Bundestag elections lay just around the corner and, given the billions of euros in expenditure and guarantees proffered to bail out the banks, any hesitation about saving the 'real economy' would have been politically disastrous for the two main government parties.

The government's recovery plan was predicated on active cooperation with both the employers' associations and the trade unions. An informal type of 'crisis corporatism' (see Urban in this volume) arose at all levels – from Chancellor Merkel's close contacts with individual union leaders to thousands of emergency coalitions formed at establishment level.

The biggest direct effect of crisis corporatism was to avert massive job losses in the crisis-stricken industrial sector. Admittedly, a substantial number of temporary agency workers were laid off. But in the labour market as a whole this decrease in employment – statistically, temporary agency work belongs to the service sector – was actually slightly outweighed by a rise in employment in other service segments. But what this reference to temporary work makes plain is that crisis corporatism could well include recourse to external flexibility whenever it was necessary to safeguard core staff. The biggest role, however, was played by internal flexibility. This was new, or rather – new once again. Only a few years beforehand, during the previous phase of recession and stagnation, many companies had trimmed their workforces to such an extent that they encountered difficulties and staff shortages when the economy recovered. This experience was still a recent memory, and in order to retain their skilled workforces companies were now prepared to suffer even sizeable productivity losses in the short term.

The return of internal flexibility found its most striking expression in the substantial reduction in per capita working time, which is widely regarded as the most important explanation of the gap between the drop in GDP and the stability of employment (OECD 2010). It was achieved by harnessing the many and varied resources of the German socio-economic model – partly new resources, but mainly its traditional strengths and others rediscovered during the crisis, which had survived the disruption and upheavals of the previous years.³ The most prominent role was played by the short-time working arrangements, which were deployed to an extent that was perhaps comparable to the crisis of the mid-1970s (Herzog-Stein *et al.* 2011). But other factors had a bearing on the cuts in working hours, too: the use of existing collective agreements on employment safeguards, an abandonment of overtime

3. For more detail on what follows, see Bosch (2011) and Lehndorff (2011).

and a using-up of the credits accruing on working-time accounts, which in some cases had burgeoned in recent years (Bogedan *et al.* 2011). These last forms of individual working time reductions, above all, had at least as powerful an effect on the volume of labour in the overall economy as did (collective) short-time working (Fuchs *et al.* 2010).

The less high-profile resources of the German socio-economic model, which enabled internal flexibility to be prioritised during the crisis, included – despite all of its problems – the vocational training system, whose strategic importance for companies and employees alike was not challenged even during the crisis (Voss-Dahm 2011). The immediate effect of this was that, initially, the youth unemployment rate did not rise sharply; by 2011 it had even fallen below its 2008 level (although, as in other European countries, the proportion of young people in insecure jobs is well above the average rate for all age groups; Destatis 2011).

3.2 Scarring effects of the neoliberal upheaval

Returning to the traditional strengths of the German socio-economic model was undoubtedly the main cause of the so-called ‘employment miracle’ during the economic crisis. The upheaval of the previous years nevertheless made itself felt. The rapid, sharp decline in temporary agency work showed how far the dualisation of the labour market had already progressed. It was only thanks to the brevity of the crisis that this had not yet been reflected in the overall balance of the labour market. Less obvious, but equally important, is the dualisation in respect of the much-praised flexibility of working time. During the crisis the ability to dismantle working-time buffers was often regarded as a blessing, but these buffers had of course been built up previously – above all in the form of substantial credits on working-time accounts. In the metalworking industry, for example, the average real working time of full-time employees had increased by an hour between 2003 and 2008, whereas initially the number of core staff had been further reduced (Lehndorff *et al.* 2010).

The rediscovery of traditional virtues should not, therefore, obscure the fact that old strengths were marked by new weaknesses. Likewise, the revived Social Partnership was not the old one, but a new one – and

with a totally different balance of power. The contradictions, imbalances and fragilities which had taken hold within the German model following the neoliberal-inspired upheaval of the 1990s onwards persisted during the crisis – and are still with us today.

Their persistence first became apparent – paradoxically – in the state of the economy. Sudden and dramatic though the collapse into crisis was, the upturn from the second half of 2009 onwards was equally rapid – and both were export-driven. This was fortunate, since the upturn came about so quickly that the crisis had not yet infected the service sector (because redundancies in industry were postponed and because of comparatively good wage growth in the previous year). Many manufacturing firms in Germany were, in a sense, awaiting the turn of events with their engines running idle. In many instances the crisis had also been used for streamlining purposes. Once foreign demand picked up again in the third quarter of 2009, the skilled core staff were still on board, short-time working was terminated, the laid-off temporary workers were reinstated and the now-empty working-time accounts could be restocked. The traffic lights turned green – mainly thanks to foreign demand, as usual. Business could resume or, rather, carry on as before the crisis.

4. After the crisis?

The heading of this chapter ends with a question mark for obvious reasons. The first phase of the major economic crisis may have been overcome for now in Germany and some other countries, but the huge problems affecting the Eurozone and the US economy stoke fears of a fresh collapse. Germany is contributing to these uncertainties, just as it helped to prepare the ground for the economic crisis. And, as before the crisis, the external impression is quite different this time too: the German economy's growth rates until spring 2011 were among Europe's strongest since late 2009, and Germany is regarded as a mainstay of stability in an environment dominated by the euro crisis and excessive government debt. But here, too, appearances are deceptive: so far there are no signs whatsoever of a move away from the bad habits that led us into the crisis and have been analysed above. In essence, what Paul Krugman (2010) described as 'the strange triumph of failed ideas' with reference to the United States applies likewise to Germany: 'Free-

market fundamentalists have been wrong about everything — yet they now dominate the political scene more thoroughly than ever.’ However, one key distinction must be drawn between now and the time before 2008, and perhaps also between Germany and the United States: ‘free-market fundamentalism’ has become very unpopular in Germany. Thus German fundamentalists are having to engage in a dizzying balancing act between rhetoric and practical policies. The vehicle for this act is the alleged need for short-time reductions of sovereign debt as a top priority.

Before turning to this overarching topic, we shall briefly outline the most evident signs of a return to the basic economic constellation that existed prior to the crisis.

4.1 ‘Beggar and lecture thy neighbour’

The biggest proportion of the GDP growth achieved in 2010 – a remarkable 3.6 per cent – consisted of the external component (1.3 per cent) and fixed capital investments (1.1 per cent), which once again were driven to a large extent by very positive export expectations. The contributions from government (0.4 per cent) and private (0.3 per cent) consumption expenditure lagged a long way behind (Hohlfeld *et al.* 2011). Thus Germany is ‘not really an economic driver, but is partly being pulled along by the outside world’ (Niechoj *et al.* 2011, p. 18). Despite a slight uplift in collective pay deals in 2011, these will lie below the inflation rate on average (Bispinck/WSI-Tarifarchiv 2011). As for the near future, it is not yet possible to tell whether the trade unions, where they still remain resilient enough, will try to go beyond the attempt to ‘exhaust the scope for redistribution’ and once again make the goal of income redistribution an element of their effective pay policy.

Other indicators also point to ‘pre-crisis reloaded’: the proportion of low-wage employees and households rose again in 2009, even going slightly above the pre-crisis level (Bosch 2011). Similarly, the number of temporary employees in late 2010 exceeded the maximum level reached before the crisis: about half of the increase in employment during the first year of the recovery since mid-2009 is attributable to temporary agency work (BA 2011). Last but not least, after short-time working was scaled down, working time has lengthened again – with all the

problematic implications for job creation that one might expect: in the first quarter of 2011 the actual working time of full-time employees had already returned to the pre-crisis mark of just under 41 hours per week (IAQ 2011). After a very short while the prediction made by Bosch (2011: 282) was already borne out: the 'dualisation of the German labour market was not so evident in the crisis, but may become more visible in recovery.'

The obstacles to pursuing this course are mounting, however, first of all on domestic political and economic grounds. Many industrial companies are becoming increasingly concerned about a future lack of skilled manpower. While the validity of these concerns is open to doubt, the problems associated with demographic change and an ageing workforce do lend grist to the mill of those who prioritise sustainable human resources strategies rather than the short-term exploitation of pay differentials in dualised labour markets. Secondly, the political obstacles are also mounting. Trade union pressure for unconditional equal pay for temporary workers and for a statutory minimum wage is garnering ever more support from the public. So far, this has changed nothing as regards the factors described above, which led to the expansion of the low-wage sector and to the stagnation, or even decline, in average pay. This is all the more true in that none of the existing or potential parties of government is calling into question one particularly heavy burden on future wage growth, namely the so-called Hartz reforms. Nonetheless, the wage restraint strategy is unlikely to operate quite as smoothly in future as it did before the crisis.

There could, in addition, be external economic reasons. Since 2009, the German government has turned wage restraint into a piece of 'advice' given to other countries. More accurately, other countries are virtually being compelled to follow Germany's lead in order to become more competitive and reduce their government debt. The problem here, at least within the Eurozone, is that if everyone were to follow Germany's example the country could continue to pursue its existing export surplus strategy only at the cost of greater pressure on pay and an even greater extension of the low-wage sector in Germany. Whether or not this could be implemented at a domestic level is debatable. Paradoxically, therefore, Germany's policy of 'beggar and lecture thy neighbour' is in the process of undermining the prerequisites for its success to date.

Another problematic element may be an attempt, in the absence of an expanding domestic market, to steer soaring capital income into the international financial bubble that is once again growing in size and continues to be mostly unregulated. US private sector debt is now of much less significance as a source of returns for German banks, and the strong commitment, for example, to Irish or Spanish government bonds at attractive interest rates is shrinking progressively, on account of the associated risks (Horn *et al.* 2011). No equally attractive alternatives are evident in the present global economic climate. This makes the markets 'nervous' and an export-dependent economy such as Germany's especially volatile.

All of this is happening against the backdrop of a sudden rise in government debt.

4.2 A lifebelt for neoliberalism

'The crisis started with too much private debt and leverage, which became public debt and deficits as crisis and recession triggered fiscal deterioration and private losses were mostly socialized via bailouts of financial systems' (Roubini 2010). The extent of, and level reached by, the upsurge in Germany's public debt (from 65 per cent in 2007 to 83 per cent in 2010) corresponds roughly to the average level for all EMU Member States (Horn *et al.* 2011). In fact, new debt has so far risen less rapidly than was originally feared, since the growth of the economy and the tax take in 2009 and 2010 were surprisingly robust. This created scope for the abovementioned, albeit small, positive contribution to growth made by public spending in 2010 – a virtuous circle that was denied to other countries, given the alleged need to reduce new debt immediately. There was, in addition, a little-noticed side-effect of the continuing crisis in the Eurozone: German federal treasury bills became such a sought-after investment that their yields temporarily fell from just under 5 per cent in mid-2007 to a historic low of roughly 2 per cent from summer 2010. That is, when writing this chapter in late 2011, for more than a year the interest rate for German government bonds has provided for the refinancing of public debt at zero cost in real terms amidst what is widely perceived as a European 'debt crisis'. This remarkable 'safe haven effect' (Deutsche Bundesbank 2011b: 42) has

substantially moderated the rise in the Federal Republic's budget deficit and must be regarded as a kind of crisis dividend.⁴

These factors have so far enabled German politicians to moderate the pace of the austerity approach. But it is becoming clear that the consolidation measures being introduced are focused primarily on cutting welfare spending (Heise and Lierse 2011). For the time being, the 'need to cut government spending' is being portrayed as something that will demand considerably more sacrifices in other countries than in Germany. What is more, the constant references to other countries, which ought at long last to begin managing their economies as efficiently as the Germans, and for whose debts 'we Germans' should not have to take responsibility, represent an ideological stance that – as already happened at the start of the crisis – made Germany appear to be a victim of the crisis and not one of its creators. In essence, this argument is similar to that of right-wing populists in other European countries.⁵

But even under the austerity regime, the days of 'beggar and lecture thy neighbour' are numbered. There is much to be said for the assumption that, in light of ever-increasing private wealth, *public* poverty in Germany will become more and more painful in the short- and medium-term future. Over the past two decades public investment as a share of GDP has fallen to a level far below the EU average (Dullien and Schieritz 2011). The public finance difficulties are particularly noticeable at regional level and above all in municipalities. However, the endogenous strengths of the German economy derive increasingly from investment not just in bricks and mortar but primarily in people: from an efficient education and training system to all the social services

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4. It should be noted that this crisis dividend is acknowledged neither by German policymakers nor by commentators. Since the beginning of the Eurozone crisis the focus has been put on the denial of what is called a 'transfer union' to countries with high public debts. What is neglected, however, is the transfers caused by the imbalances within the Eurozone which have been quite beneficial for German economic elites over the past ten years and continue to be so for the time being.
 5. The following statement by the president of the French Front National, made in summer 2011, will serve as an example: 'We have enough poverty, adversity and unemployment at home to refuse to see tens of billions of French euros, earned through the work of French people, paid to other countries. We have enough debt of our own to refuse to pay for that of others. The Germans have fully understood this, and are now refusing all further efforts to restock the coffers of other countries' (M. Le Pen 2011).

that make it possible to draw much more heavily on skilled female labour. A constitutional cap on government debt, which German politicians believe should be extended to all the euro countries, has already been introduced in Germany with the approval of all the current and potential parties of government. The painful effects of these constraints on future government action will become all too apparent in the course of the current decade – including in Germany (Truger and Teichmann 2010).

Meanwhile, the political agenda is dominated by the foot-dragging of German politicians, prompted by domestic concerns and dogma alike, over a solution to the crisis in the Eurozone. This enhances the crisis dividend for the German government in the short term, but in the medium term the foundations of monetary union will be further undermined. Equally important, perhaps, is an ideological effect of this policy: the focus being attached to government debt serves as a lifebelt for ‘failed ideas’. The neoliberal policy of dismembering the public sector is being pursued with the help of a new ‘justification’.

5. Looking ahead: beware the German model!

Some 15 years ago, in the heyday of the dotcom boom and the political victory of privatisation and labour market deregulation missionaries all over the advanced capitalist world, a group of non-mainstream US economists published a book titled ‘Beware the U.S. model’ (Mishel and Schmitt 1995). The intention was to ‘provide concerned Europeans with views of the actual American experience’ (Faux 1995: x) by highlighting the downside of the US economic success story of these years, including the growing low-wage sector, income deterioration and rising inequality. As we know today these were exactly the problems which gave way to the subprime bubble of the past decade which eventually sparked the world economic and financial crisis (Krugman 2009). Of course, the economy and the social order of Germany today cannot be put on a level with the US in the 1990s. However, the enormous pressures exerted by Europe’s strongest economy and its political leaders, based on a combination of persistent and massive current account surpluses with an actual fiscal dictatorship within the monetary union, is about to suffocate economic recovery and social equity in many other EU countries. The side effects on the world economy may

be substantial, and the backlash on the German economy will be inevitable. Thus it is time to modify the earlier warnings of our US colleagues: Beware the German model.

Today's German model of capitalism – a hybrid consisting of a few preserved components of 'Rhenish capitalism', neoliberal-inspired reconstructions and demolitions of this classic model over the past 20 years, along with stubborn refusals to reform the conservative welfare state – may be admired at home and abroad as a model of success. Such praise overlooks three facts. *First*, the 'employment miracle' of the years 2008–2009 is attributable primarily to those elements of Rhenish capitalism that survived the so-called reforms of the previous years. *Second*, the economic success of the past decade – and once again since 2009 – relies to a considerable extent on a combination of renewed vigour in manufacturing industry (which, likewise, would have been unthinkable without the surviving elements of the classic German model) with increasing social differentiation and division. As a result, average pay has stagnated and even declined, which not only makes Germany more price-competitive – especially compared with the other Eurozone countries – but also makes the fate of the German economy ever more dependent on the success of its export industry. *Third*, specifically through its neglect of the domestic market and by widening the income differentials on which it relies, this new German capitalism is helping to destabilise the Monetary Union, as well as to create a global economic imbalance and ever more financial bubbles.

This supposed model of success is far more fragile and vulnerable than its advocates would have us believe. A Monetary Union that accepts this model as an example and goes along with the political dominance of its leaders is skating on very thin ice. The heavier the millstone that Germany imposes on the Monetary Union, the greater the danger that the ice will break.

Most paradoxical thing of all is that Germany, its economy and its society, have a great potential to play a positive role in Europe. German industry could develop its strengths in the field of environmental renewal, buoyed by a comparatively broad consensus in society on the sustainable use of natural resources. A better social balance within Europe's biggest economy would lessen the constant pressure on other countries in the region, and especially on the Monetary Union, to make

social security cutbacks and reduce wages. Germany could become the engine of a more sustainable new way forward for the EU in social and environmental terms. This would, among other things, be very beneficial for democracy in the EU and its Member States.

However, such a new way forward can be achieved only with root-and-branch reform of the German socio-economic model – a reform that would restore to this term its lost connotations. Its most important elements include, first, a bolstering of public investment and social services, which will not be feasible without substantially increased taxes on capital revenues, profits and higher incomes; second, a gender-related modernisation of the welfare state; and third, support for the weakened collective bargaining system by means of a statutory minimum wage, extended universal application of collective agreements, unconditional equal pay for temporary workers and an obligation for public procurement contracts to comply with (universally applicable) collective agreements. Such reforms would, moreover, trigger a virtuous circle for the national budget, consisting of growing revenues, improved services and a reduction in inequality.

But all this is a long way off. Meanwhile, the ‘failed ideas’ are triumphing yet again. The paradoxical basis of this triumph is the sudden rise in public debt, caused by the faith in these very ideas, and its vehicle is the austerity regime being imposed on the Eurozone. All this goes to show that, this time round, the failed ideas are not being held out as a promise of fortune; instead, their latest triumph is based on intimidation and fear. This is nonetheless a sign of realism, in that a refusal to learn can only generate further crises. We can only hope that the European project will not be among its next victims.

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France confronts the crisis: economic symptoms exacerbate social inequality

Florence Jany-Catrice and Michel Lallement

1. Introduction

The economic crisis at the end of the 2000s was costly for the French economy. The number of employees in the non-agricultural market sector fell by 187,000 between the start of 2008 and the end of 2009. Never in the past forty years had job losses been so high. Overall, 412,000 jobs were eliminated in 2009. But this crisis does not boil down solely to job losses, nor even to a collapse in the growth rate (economic activity slumped by 2.2 per cent in 2009 alone): it is also rooted in economic and social inequality. And the responses provided by France's political authorities, in turn, had a distinct effect on the scale of this inequality. All of which conspires to permanently weaken the bedrock of the welfare state, and more generally the French model. We should like to demonstrate this by looking, first, at how this model evolved before the crisis. Next we shall examine the way in which France reacted to the crisis, in particular as concerns its labour market. Lastly we shall attempt to learn lessons from, and consider the implications of, the economic crisis three years after it erupted.

2. Transformation in the French model before the crisis

France fared no better than other Western countries in terms of escaping the neoliberal wave during the 1990s and 2000s. With a longstanding reputation for its Jacobin traditions, among other characteristics, France no longer looks the same today as it did at the end of the twentieth century. Various factors have contributed to its transformation. The first is the abandonment of a financial system based essentially on banking. In the 1970s, 92 per cent of all investments were financed out of bank funds. Since then, financiali-

sation has made its mark, putting France among the most highly financialised¹ countries in the world, close behind a few tax and regulatory havens.² Several processes have contributed directly to this trend: the development of financial innovations, securitisation (a device for converting illiquid assets into securities that are easy to trade on the market) and the increasing space occupied by institutional players, such as unit trusts, pension funds and insurance companies. The consequence of such commoditisation is that, measured in terms of securities (the price of financial assets), the stock market sphere has progressively been gaining ground to the detriment of the real sphere. In 1994, bank loans accounted for 55 per cent of all funding sources available to economic operators (recourse to financial markets, self-financing). In 2000, and just prior to the 2007 crisis, this figure reached 40 per cent. What is more, borrowers are in a more awkward situation now than in past decades, as the financial system has served to make lending arrangements more fragile. Thus the financial markets have assumed a growing role in the French economy. Whereas the value of securities quoted on the financial markets was rising at a slower rate in France than in the English-speaking countries before the crisis, the rate was impressive nonetheless: the accumulation of capital represented 112.7 per cent of French GDP in 2000; by 2006 it had risen to 149 per cent.

A shake-up in the production system, in conjunction with financial change, constitutes the second noteworthy feature of recent transformations in the French economy. The 1990s saw an extensive process of financial and organisational concentration, resulting in particular in mergers and acquisitions in many economic sectors. With a view to refocusing on core business, the main challenge was to cut costs and make economies of scale so as to achieve more rapid returns on revenue-earning assets. Against a background of wage restraint, this merger strategy – which in many instances resulted in crushing failures – reinforced the fault-lines running through the labour market. Owing above all to a large phalanx of working poor, unable to meet all their needs out of their wages alone, authors began to speak of the mounting significance of a real ‘precariat’ at the centre of the French wage-earning classes (Castel 2003). French trade unionism, short of

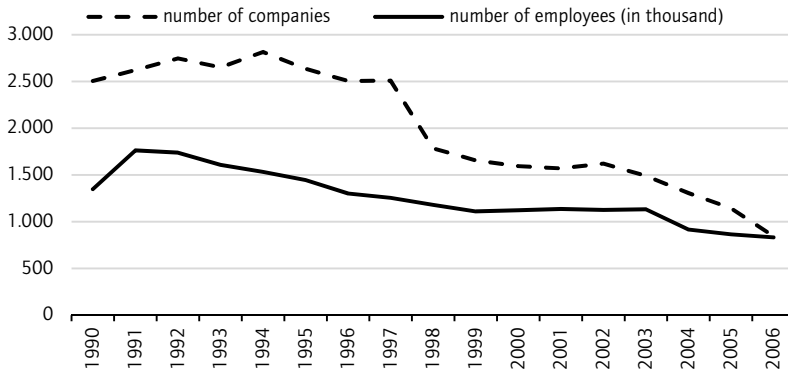
1. Meaning the activities of stock markets, bond markets and banks.

2. Luxembourg, Ireland and the United Kingdom.

members as always and more divided than ever, was as ill-equipped as others to confront this issue. Collective bargaining, having become more decentralised and much more inclined than before to countenance negotiations on labour and employment flexibility, did not facilitate the task of engaging in well-structured industrial action. Sometimes, however, protests have been initiated by a new kind of network, emerging from a better-organised civil society (the farmers' confederation, housing rights associations and so on). These groups usually act alongside, rather than in close connection with, traditional trade unions.

Third, whereas the French model had long benefited from a vast body of public enterprises, it underwent a huge upheaval: various waves of privatisation, initiated in 1987 and pursued ever since – including by left-wing governments – drove down the number of companies under majority state control by almost half (see Figure 1).

Figure 1 **Number of companies under majority state control and number of employees**



Source: List of companies under majority state control, Insee.

Moreover, numerous reforms have been made since the late 1980s with a view to relieving the debts of public enterprises and streamlining public expenditure – which often meant a withdrawal by government and cuts in public sector jobs. Other aims were to improve the supervision of such companies, carry out internal reorganisations (establishment of independent managements), transfer certain operations to local authorities, simplify and improve relations between the citizens

and the administration (for example, by setting up one-stop shops) and so on. From the former National Employment Agency to the public hospital sector, via national education and the finance and justice departments, no sector would be spared. The 2001 Organic Law on Financial Legislation (OLFL) and the 2007 General Review of Public Policies (GRPP) – French provisions enacted in the framework of New Public Management – completed the major ‘renovation’ efforts undertaken within government. The OLFL sets up a public finance management system reliant on performance-based commitments and no longer solely on the consumption of resources. It relies mainly on batteries of indicators which are supposed to reflect the outcomes of public sector activity. Because it imposes expenditure ceilings and a new means of regulating the transfer of expenditure between headings (this is the ‘asymmetric fungibility’ rule, whereby personnel expenditure funds can be diverted to other uses but the opposite is not possible), one of its effects is to limit opportunities for job creation in the public sector. As for the GRPP, its goal is to cut public spending while boosting the efficiency and quality of public sector activity.

Although they partly predated the 2007–2008 economic crisis, these measures heightened the government reforms. This applies to the 2010 pension reform which dismantles the pay-as-you-go pensions system even further, despite the fact that it was a pillar of the French solidarity-based welfare system. The reform consisted of a two-year deferral of the age of entitlement to a pension (now a minimum of 62 years) and eliminated the option of early retirement.

3. French reaction to the 2008 crisis

In 2008, like everywhere else, the macroeconomic indicators for France turned red. According to the French National Institute for Statistics and Economic Studies (INSEE), GDP fell by 2.8 points between 2007 and 2009 (compared with 3.2 points on average for all the European Union countries), investment fell by nearly 9 per cent, imports by 11 per cent and exports by 12 per cent.

As for the unemployment rate, it jumped three points over the same period. Even though the situation portrayed in Table 1 looks rather bleak, France was not one of the countries hardest hit by the shock of

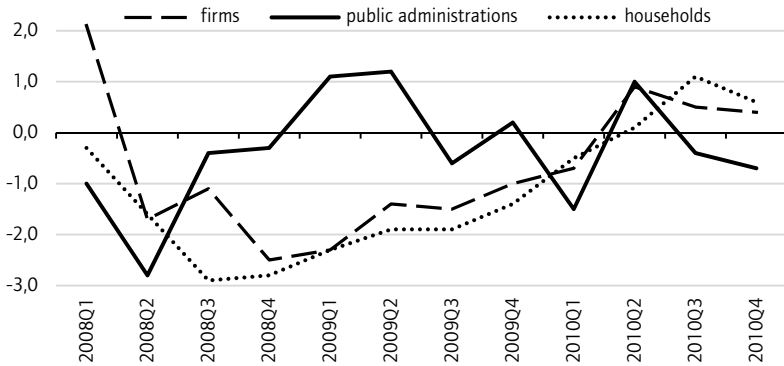
the crisis overall. Indeed, by comparison with the last recession in the early 1990s, the country seems to have held up better, at least in terms of jobs. While in 1992–93 added value in the non-agricultural market sector decreased by 1.9 points and employment by 2.1 points, for the years 2008–2009 the figures are –5.3 points and ‘only’ –2.5 points. In other words, although as an absolute value job erosion has never been greater, as a relative value (trend in employment against that of GDP) we note that the market did not collapse as badly as it did at the start of the 1990s. There are various reasons for this comparatively better performance of the French economy and labour market. Unlike many other countries, first, the rate of savings among the French populace was relatively high before the crisis (approximately 15 per cent), which made it possible to avoid a drop in consumption at the time of the economic shock: consumption even rose by 1.4 per cent from 2008 to 2010, whereas it fell by 0.5 points in Germany and 1.5 points in the United States. Another key factor explaining the relatively good performance of the French economy is the support from the public sector in terms of investment (Figure 2). These short-term developments form part of a structural trend which, since the 1990s, has put France at an advantage vis-à-vis its age-old rival Germany with regard to wealth creation, investment and consumption alike (Horn *et al.*, 2010). Put differently, by comparison with Germany, more sustained domestic demand in France made it possible to compensate for poorer export performance and hence to better withstand the shock of a global recession.

Table 1 **GDP and its components by volume (progression in %)**

	2007	2008	2009	2010
Gross domestic product	2.3	– 0.1	– 2.7	1.5
Imports	5.5	0.9	10.8	8.8
Gross fixed capital formation (Investment)	6.3	0.3	– 9.0	– 1.2
Exports	2.3	– 0.3	– 12.4	9.7

Source: National Accounts - Basis 2005, INSEE.

Figure 2 **Investment trends, France, 2008–2010**
(quarterly rates of change, percentage)



Note: Household investment corresponds to housing purchases.
Source: INSEE.

This public sector support, which had no equivalent on the consumption side, is one component of a recovery plan worth around 34 billion euros for 2009 and 2010 (see Box 1). The plan was severely criticised by the French Court of Audit, first and foremost because it sacrificed consumption to the exclusive gain of investment. Although it has undoubtedly limited the number of bankruptcies and eased companies' cash-flow situation, the plan has not lived up to all of its promises. Whereas investment by public enterprises should have reached 4 billion euros in 2009, only a quarter of that sum was achieved. Furthermore, whereas the government thought that this plan would enable it to create or safeguard the equivalent of 400,000 jobs, the Court of Audit considers that in fact between 18,000 and 72,000 jobs were created during that period. Last but not least, the cost of the recovery plan (equivalent to 1.4 per cent of French GDP) proved exorbitant by comparison with its benefits: the Court estimates its impact on growth at around 0.5 points in 2009. The recovery plan, as implemented, did not square up to the announcements made by the French government. Worse still, even if it did help to prop up demand, it yet again revealed the Sarkozy government's overall inclination to prioritise companies rather than employees.

Box 1 Main recovery measures adopted by the French government in 2009

- Finance facilities for SMEs.
- Car scrappage premium, automobile pact.
- Public investment: 4.1 billion euros of direct state investment in transport (TGV high-speed trains, Seine-Nord canal, Fréjus safety tunnels and so on) and 4 billion euros of investment in large public enterprises.
- Establishment of a strategic investment fund: 20 billion euros of funds intended primarily for the automotive, aeronautical and timber industries.
- Establishment of a social investment fund (a brainchild of the CFTD) endowed with 1.5 billion euros and 50 per cent state-funded, to coordinate efforts around employment and to consolidate the different sources of funding.
- Compensation for short-time working measures raised (from 60 per cent) to 75 per cent in sectors concluding agreements with the government; 'harnessing' of vocational training to avert or accompany part-time work.
- Abolition of the provisional last two-thirds of income tax due in 2009 (affecting more than 4 million tax households in the first taxation band); tax relief to reduce the taxes on 2 million additional households.
- Premium of 150 euros for 3 million families with school-age children in receipt of the schooling expenses allowance.
- Allocation of coupons for the purchase of personal services worth 200 euros per household to the 660,000 recipients of the individual home-assistance allowance, to the 470,000 families with young children in receipt of the childcare supplement and to jobseekers who find work and need a temporary childcare solution.
- 100,000 additional assisted contracts (over and above the 230,000 scheduled) in 2009.
- Establishment of a crisis assessment and monitoring committee.

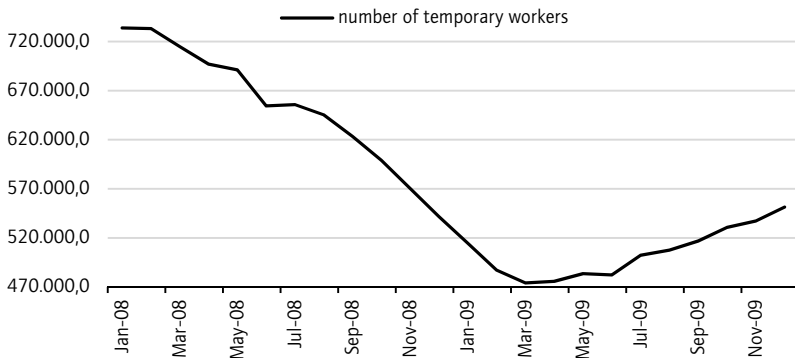
Companies, for their part, conducted themselves in a manner corresponding broadly to what one might expect in the light of past experience (Liégey 2009). As is logical on domestic markets, large French companies began by protecting their skilled workforces by resorting to short-time working arrangements.³ The crisis afforded an opportunity to reactivate these arrangements, which had seemed to be falling gradually into disuse. The number of employees covered by short-time working authorisations plummeted by 82 per cent between 1996 and 2005, down from 1.7 million to 300,000 (Calavrezo *et al.*, 2009). The scheme was reviewed in 2008 so as to enable companies to spread the work reduction imposed on employees over a longer time period. The economic crisis accelerated the use of this new formula. Thus, in the automotive sector, one employee in ten was put on short-time working in the first half of 2009 (Conseil d'analyse stratégique 2009). French companies also made their most insecure workers bear the brunt of the economic crisis. In just over a year, the number of temporary agency staff declined by a third (Figure 3), a reminder – if such were needed – that this way of working constitutes a major adjustment variable. While the contraction in temporary work mostly affected industry, the service sector reduced its volume of employment by cutting back on fixed-term contracts. Working hours, however, varied very little during the crisis, whether measured by the amount of overtime or by the recourse to part-time jobs. Therefore, the flexibility mechanisms negotiated when the 35-hour week was introduced on the cusp of the 1990s and 2000s, then during the years thereafter, did not serve to heighten the shock of the crisis.

These adjustments, cyclical for the most part, should not be allowed to mask a delicate structural situation, both economic and social. Thus, in 2011, unemployment has stabilised at a particularly high level in France (between 9 and 10 per cent, according to the ILO measure); this stability contrasts with a sharp rise in long-term unemployment. DARES (research body of the French Ministry of Labour) refers to a rise of 500,000 long-term unemployed between 2008 and 2010 (Timbeau 2011). This structural persistence of a high unemployment rate in France has permanently slowed down wage growth and has sapped effective

3. By contrast, this option was scarcely used at all by small firms, which might explain another difference with Germany, a country that utilised such arrangements to a much greater extent.

demand. In the very midst of the economic crisis, a net fall in average annual disposable monetary income per household was even recorded. In 2009 euros, this disposable income, which takes into account net pay, investment income, social benefits and various taxes and transfers, went down from 41,317 euros in 2008 to 40,603 euros in 2009: a drop of almost 2 per cent (*Alternatives économiques* 2010).

Figure 3 Evolution of temporary work (intérim) in France



Source: Pôle emploi.

4. Lessons learned and looking to the future

Where do we stand, three years on from the 2008 crisis? We cannot give an exhaustive answer, but we believe that three facts, each one representing a major challenge, lie at the heart of a French model that did not emerge unscathed from the economic turbulence.

4.1 A halt in structural productivity?

One initial consequence of the crisis in France relates to productivity. Apparent per capita labour productivity declined between the 1980s and the early 1990s (Berrebi *et al.* 2009). Then, despite having risen steadily since 1990 (up by 10 points from 1990 to 2007), productivity fell back sharply in 2008. This phenomenon can be viewed as the result

of labour retention strategies which, amidst a deep cyclical recession, inevitably caused a drop in productivity. Some economists, however, diagnose much more than a cyclical effect. Noting the atypical nature of the 2008–2009 productivity cycle, they posit that in fact two phenomena acted jointly: on the one hand, a lesser adjustment of employment to activity and on the other, a weakening of the trend in productivity gains. This second phenomenon, whose exact scope has not yet been understood, ‘was observed in the early 1970s and on the cusp of the 1990s. A distortion of the structure of the economy between the various sectors, in particular, can lead to such a trend. If it takes hold, this decline in productivity gains is not necessarily good news for the economy, however, given that the halt in productivity would mean a lasting downturn in potential economic activity: in the long term the levels of added value and employment will be lower’ (Argouarc’h *et al.* 2010: 24–25).

Recent studies on sector-based productivity provide some possible explanations for France (Schreiber, Vicard, 2011). Tertiarianisation of the French economy accounts on its own for more than half of the productivity losses observed since the start of the 1990s. But the causes of the slowdown in labour productivity recorded since the start of the 2000s need to be sought elsewhere. This time, in fact, the slowdown is the result of a concomitant drop in productivity gains across all sectors: agriculture, industry, construction and market services. As we can see, in France the economic crisis is perhaps more than just a fleeting bad memory.

4.2 Public deficit and territorial inequality

One typical feature of the state of the French economy is the size of its public deficit. Although part of the deficit was structural and linked to the ‘Jacobin’, social nature of the state – a source of pride for the French government at least until the mid-1980s – the same cannot be said of the past decade. This period has in fact been characterised by a decrease in tax revenue, a major cause of imbalance in the public finances. Having peaked at 22.5 per cent of GDP in 1982, government revenue accounted for just 15.1 per cent of GDP by 2009 (Aurissergues 2010). In addition, following a series of reforms (initially in 1982 and then in 2003–2004) aimed at decentralising the French state, certain powers were devolved to the local authorities (regions and departments), especially in the social and education fields. Spending by local public

administrations has grown more rapidly than that of any other authorities over the past thirty years, up from 7.7 to 11.3 per cent of GDP from 1978 to 2008 (Champsaur and Cotis 2010).

Whereas decentralisation is founded on a logic of localism (by handling local situations according to need) and on the principle of subsidiarity, it has also served to heighten spatial inequality over access to public services: this is unheard-of in the French tradition of equal rights. Marked contrasts between French regions are becoming increasingly evident. For instance, even though the Nord-Pas de Calais region partially succeeded in restructuring itself and managed to eradicate some of the scars deriving from its industrialisation in the nineteenth century, a substantial amount of poverty persists there. Its GDP is almost twice as low as that of the Ile de France region, the proportion of individuals without any qualifications⁴ reaches 36 per cent – 10 points more than in Ile de France – and life expectancy is also four years less.

4.3 Mounting economic and social inequality

In the wake of the difficulties encountered since 2008, justification of income inequality has become a recurrent topic of debate in French political circles. This may come as a surprise, but in fact France is sometimes regarded as unusual by comparison with its European partners. It 'is one of the only countries in which the interdecile ratio for earned income declined between 1995–1997 and 2004–2006, reaching a value of 2.9 in 2006' (ONPES 2010: 81). But this finding derives mainly from the observation tools used: the interdecile inequalities on which the observations focus overlook the greatest inequalities, which are located at both extremes of the income and assets scale. Indeed, income growth among the richest households in France has been spectacular – albeit before the crisis. Thus, according to INSEE, the annual earnings of the wealthiest 0.01 per cent of people grew by more than 40 per cent in just three years (between 2004 and 2007), whilst those of the poorest 10 per cent grew by just 6 per cent over the same period. What is more, the principal inequality in France derives not from annual earnings but

4. In other words, not having any formal qualifications at all, except perhaps for the school leaving certificate obtained at age 16.

relates to the concentration of assets, which often elude conventional measurement tools. In reality, not only are assets very unevenly distributed, but inequality in this domain has been increasing for several decades under the combined effect of a succession of policy measures favouring owners of large fortunes in France, leading to the consolidation of 'inherited' French capitalism (Philippon 2007). In 2003, the top decile possessed nearly half of all French assets (47 per cent). This situation has been worsening since the 1980s, and even more so since the 1990s, owing to successive tax breaks on the taxation of assets (inheritance, wealth and, more generally, capital taxes). Part of this tax relief is no doubt attributable to the symbolism of a policy of looking after 'the well-off'; on the other hand, another part of this relief exacerbates economic and social inequality on a lasting basis and, as pointed out above, contributes to the lack of balance in budget deficits, which correspondingly reduces the scope for social policies to assist those who are worst-off.

4.4 Poverty: the crisis and a new social issue

There is a similar issue that has been, and still is being, thrown into sharp focus by the economic crisis: namely the advance of poverty, the working poor and the economic policies responsible for these social fissures. The crisis is not solely responsible for the rise in insecurity and poverty, but it has increased their magnitude.

First, as we have said, the economic crisis has pushed up the official unemployment figures. It has in addition augmented the unemployment 'halo' (in other words, all situations falling mid-way between joblessness, work and inactivity). In August 2010, France had 2.7 million category A unemployed persons (that is, those out of work and actively seeking a job). At the same time, by taking account of people in atypical employment, DARES recorded almost 4.6 million unemployed. This figure is rising steadily. It encompasses situations such as jobless persons undergoing training, workers wishing to work more (in other words, underemployment), those not registered with *Pôle emploi* (the French employment agency) and the discouraged unemployed. Moreover, the rise in unemployment is concentrated in a few socio-demographic categories, first and foremost young people, whose jobless rate went up by 25 per cent between 2008 and 2010. The economic crisis has likewise reinforced the trend towards increasing recruitment

on non-standard contracts. This form of recruitment accounted for almost 80 per cent of all hirings in 2010.

Cumulatively, these developments could lead to growth in the numbers of working poor, a concept and a reality which are both very recent. The vast bulk of poverty in France is of course primarily made up of single people who are out of work. In 2008, France had approximately 4.3 million persons living in poor households bordering on 50 per cent of median earnings and 8 million bordering on 60 per cent. The effect of the crisis was to raise this economic poverty in France by 0.5 of a point from 2008 to 2009. By the end of 2009, 13.5 per cent of people (8.2 million) were living below the poverty line, and the intensity of this poverty has grown (Lombardo *et al.* 2011). Although the proportion of poor individuals is high, the French social security system serves as a genuine safety net: in 2007, for instance, the rate of financial poverty at 60 per cent of median earnings was 25 per cent before taking account of social transfers. The crucial role of social security in lowering poverty levels (down 12 points) puts France, along with Sweden, among the most protective countries.

This social security system undoubtedly played a counter-cyclical role at the time of the 2008 economic crisis, which may be one of the reasons why, on the whole, France withstood the crisis better than its European partners. Two caveats should be attached to this statement, however. First, by attaching distinct priority to the activation side of employment policies, along the lines of Anglo-Saxon-style 'workfare' provisions, a rolling-back of social security provision may serve to augment the rise in working poor, and more generally that of in-work poverty (Ponthieux 2009). The active solidarity income, established in June 2009 and consisting of a social strand and a job activation strand, envisaged financial incentives for the return to work, coupling these cash incentives with stricter demands on jobseekers and minimum-income recipients. Having been introduced in the very midst of the economic crisis, the active solidarity income, its amount varying according to a household's circumstances,⁵ has barely proved effective. In fact, the assisted return to work for persons remote from the labour market, one

5. It amounts in 2011 to 460 euros for a single person with no children; thus this allowance equates to barely half of the financial poverty level.

of the main goals of the activation provisions, was distorted by the huge simultaneous upsurge of jobseekers in crisis-hit sectors.⁶ The number of working poor was estimated in 2008 at 1.9 million, or 6.7 per cent of persons in work; there is as yet no certainty about how it has progressed since the crisis. All we know is that the vast majority of working poor are in employment throughout the year, but that a fifth of them are mostly in part-time jobs (ONPES 2010). We also know that the self-employed – a category of workers, moreover, given encouragement by successive French governments – are overrepresented in this category.

The second caveat is that young people aged under 25 are a group that has largely been neglected by these measures. Not only have they been worse affected by unemployment since the crisis, but they are also less well protected against possible cuts in income. This is because the government provisions that ought to act as social cushioning measures are much less generous for youngsters, be it in terms of social insurance or top-up income (Zemmour 2010), as in the case of the active solidarity income which was not originally designed to assist the under-25s.

It is worth noting, finally, that the problem of poverty cannot possibly be addressed without bearing in mind its gender dimension. There are two reasons why: first, the employment activation policies attribute to certain typically female sectors (nursery assistants, home helps and care staff) the merit of constituting ‘pools of labour’. If these jobs are associated with women, it is not only because they are performed in a domestic or social environment, but also because they depend on unfavourable conditions in respect of pay, working hours and so on. The second reason why gender should be taken into account is this: unlike the working poor category,⁷ the low pay category⁸ is dominated by women, since the key determinant of low monthly wages is part-time work. And in France, as revealed by the 2009 employment survey, 83 per cent of part-time workers are women.

6. The ONPES (National Observatory of Poverty and Social Exclusion) estimates that 90 unemployed persons are supervised by every *Pôle emploi* advisor, compared with 30 to 60 under the initial plans (ONPES 2010).

7. The working poor need to meet two conditions: they must be in employment and live in a household whose disposable income is below the poverty threshold; 46 per cent of the working poor in France are women.

8. Low pay means that the wages received by a worker are less than 60 per cent of median earnings; 75 per cent of those in receipt of low monthly wages in France are women.

5. Conclusion

The 2008 economic crisis cannot be deemed an accidental occurrence in France any more than it can elsewhere. The crisis took somewhat different forms depending on countries' national models, but resulted from the upheavals in contemporary capitalism, first and foremost the financialisation of the economy. For the reasons outlined, France seems to have held up better than other countries, at least in the short term. From this point of view, the government's proactive approach – a historic trade-mark of the French model (Berrebi *et al.* 2009) – may explain part of France's relatively good performance compared with its European partners. Admittedly, the French government no longer plays the role it did twenty years ago, and policies designed to 'modernise' the public sector have handed the baton to new public- and private-sector players that are able to administer labour and employment affairs in a different manner, sometimes for the worse. Nevertheless, the ability to rapidly adopt centralised plans to combat an economic downturn has not been lost, even if it means omitting to hold proper social and political negotiations. The two crises of 2008 and 2011 provide ample evidence. But the 2008 crisis revealed and even compounded some fundamental upheavals, above all else the social inequality on which we have dwelt.

This structural trend towards more inequality and more poverty testifies to the transformations in the French model. Social solidarity has gradually been eroded over the past three decades owing to a succession of varied reforms. The surge in working poor has brought to light a new social issue. Ultimately, by heightening inequality and serving as a pretext for new liberal-inspired adjustments, the crisis has merely served to sanction a medium-term development. That is why, even though there are grounds for satisfaction that France withstood the shock of 2008 reasonably well, there is every reason to be less optimistic for the years ahead. The new financial market crisis of summer 2011, to which France has been no more immune than its partners, proves the point. The plan adopted in the wake of this new market crash reinforces and augments the liberal inclinations that have lain behind French economic policy for several years now. Will France's trade unions manage at last to turn the tide? Bearing in mind the difficulty they had in making their voices heard during the 2008 crisis, nothing is less certain. We can therefore only hope that the presidential

election campaign will provide opportunities, in 2012, for a public debate about the decisions needed in order to envisage other forms of economic and social development than those we have come to know over the past few decades.

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The Austrian model and the financial and economic crisis

Christoph Hermann and Jörg Flecker

1. The dynamics of the Austrian model

The Wall Street Journal, writing about Austria in 2006, noted that the once sleepy, corporatist economy had changed into one of Europe's most competitive thanks to 'free-market' reform and tax cuts. Perhaps this is an exaggeration. Austria still has significant corporatist institutions and the liberalisation of markets did not go as far as hoped for by the country's economic elites, especially in the area of public services. However, there is no doubt that the Austrian model has undergone far-reaching changes since the mid-1980s, when an economic crisis put an end to the post-war system (Hermann and Flecker 2009).

While in the post-war decades Austria was characterised by a high share of public ownership in industries and banks and extensive market regulation that sheltered businesses from international competition, much of what happened during the past three decades has been intended to create an environment that is attractive to foreign capital and to make native capital more competitive. Subsequent measures have included the liberalisation of trade and capital flows and the reduction of corporate taxes. Lower tax revenues aggravated budgetary problems and demands for budgetary austerity and cuts in the welfare system. As a result, economic and social policy have increasingly been subordinated to the overall objective of improving corporate profitability.

Many of the changes were facilitated through Austria's accession to the EU in the mid-1990s, which in turn led to a further Europeanisation and internationalisation of the Austrian economy. On the other hand, Austrian capital also profited immensely from the EU's eastward enlargement. But while profitability soared as a result of outsourcing and productivity increased, due to the shareholder-value orientation and eastward expansion, unemployment remained high compared to

the post-war decades (but low compared to other EU Member States). In terms of economic policy Austria has come much closer to what one might call the neoliberal mainstream.

Two aspects of the Austrian reform process are particularly interesting: the transformation took place slowly, developing over several decades – the first ‘austerity package’ was introduced in 1987 while the last major welfare cuts took place in 2003. The changes were partly masked by institutional continuity (*ibid.*). Apart from a brief period with a right-wing government (2000–2006) the social partners continued to play a substantial role in mitigating policy differences, even though the outcomes were generally more beneficial to capital than to labour. As a result, the changes took place without major resistance from organised labour. On the contrary, the trade union movement defended most of the austerity packages (except those adopted between 2000 and 2006) and Austria’s accession to the EU.

Another feature with regard to which Austria has shown remarkable stability is the conservative welfare state with a high proportion of cash-based benefits. Despite some attempts to improve the situation of women, welfare institutions continue to discriminate against women and other individuals with low incomes and discontinuous working careers. As a result, social inequalities have tended to increase despite a comparatively well developed welfare state and a stable and comprehensive collective bargaining system. Inequalities are partly fuelled by the transformation of labour markets (Atzmüller 2009). Even though Austria has not experienced a direct attack on employment standards and security, atypical and partly precarious forms of employment have emerged alongside the standard employment relationship. By far the most important form of atypical employment is women working part-time hours. The employment rate of women has increased, but it is still far below that of the Nordic countries (Mairhuber 2010).

Three aspects of the transformation of the Austrian model have made Austria particularly susceptible to the effects of the crisis: first of all, with economic liberalisation Austria was integrated more closely into the European and world economies, while very moderate real wage growth and austerity policies made it even more dependent on exports and hence on external demand. Second, the privatisation of the banking system spurred the transformation of the banking sector from a public utility into profit-maximising businesses which are more than willing to take major

risks if they promise extraordinary returns (although the crisis has shown that public ownership does not necessarily prevent bank managers from making risky investments). EU enlargement into Central and Eastern Europe encouraged Austrian banks to turn themselves into international companies with major branches in the new member states. For years these investments generated extraordinary returns but they have turned out to be a major liability during the crisis. Third, low real wage growth and a persistent fall in the wage share (wages as a proportion of GDP) have not only limited internal demand but have also contributed to the trade imbalances within the European Union, aggravating the crisis for a number of peripheral member states and ultimately threatening the European integration project.

2. The crisis in Austria

The crisis hit Austria in the second half of 2008, ending a phase of accelerated growth that had started in 2003. GDP growth rates reached 3.5 per cent annually in 2006 and 2007, fuelling profits and inflation. After years of stagnation, workers also capitalised on the favourable economic climate and achieved significant real wage increases in 2006 and 2007. Growth also resulted in a fall in the unemployment rate below 4 per cent (Labour Force Survey) just before the crisis struck in 2008. GDP growth fell in the last quarter of 2008, but overall GDP still grew by 2 per cent in 2008 (Scheiblecker *et al.* 2010: 322).

The situation changed in 2009. In the first quarter of 2009 the economy contracted by 2.2 per cent compared to the fourth quarter of 2008 and by 4.9 per cent compared to the first quarter of 2008. The economy continued to shrink until mid-2009 with the effect that GDP fell by 3.6 per cent annually. The last time the Austrian economy recorded such a decline in GDP was in 1949 (Scheiblecker *et al.* 2010: 323). Despite the massive blow the Austrian economy still performed better than many other European economies, including Germany where GDP fell by 5 per cent (*ibid.* 234).

The Austrian economy is highly dependent on exports. While the main trading partner is still Germany, Austria has intensified its economic relationships with new EU Member States in Central and Eastern Europe, following the opening of these economies after 1989 and their accession to the European Union (Hermann and Flecker 2009). While Austria profited from years of above average growth in the CEE countries, the

massive exposure of Austrian banks in the region turned out to be a major risk when the crisis unfolded. Total bank assets fell by 3.3 per cent in 2009 (Scheiblecker *et al.* 2010: 323).

Apart from the banking sector, which was saved by the adoption of a 100 billion euro rescue package, the crisis initially affected mainly the export sector. Total exports fell by 20 per cent in 2009. Among the export sectors, manufacturing was hit particular hard and within the manufacturing sector the main victims were producers of investment and durable consumption goods and related intermediate products. Output in manufacturing started to fall in the fourth quarter of 2008. Some manufacturers struggled with a 30 to 50 per cent decline in orders (Hermann 2011). The pace of contraction increased markedly in the first quarter of 2009 when value added diminished by 6 per cent. Over the year value added fell by 11.7 per cent (Scheiblecker *et al.* 2010: 369–70).

Construction, too, was severely exposed to the crisis. Even though Austria experienced a marked growth in construction in 2006 and 2007, the boom was not comparable to the Irish or Spanish housing bubbles. When demand started to diminish in the second half of 2008, construction firms still had plenty of work in their books from existing contracts. But in 2009 the lack of new contracts led to a substantial fall in construction activities. Output decreased by 7.6 per cent in the first quarter of 2009 and by 2.3 per cent annually (Scheiblecker *et al.* 2009: 372). The decline in private demand was partly offset by public investments. These investments spurred growth in the construction sector in the fourth quarter of 2010 (*ibid.*).

The economic crisis quickly turned into a labour market crisis, but the reduction in employment was less severe than the contraction in GDP. While GDP fell by 3.6 per cent in 2009, unemployment increased by 1.4 per cent (*ibid.* 361). The number of unemployed persons increased by 57,000 from June 2008 to June 2009, while the number of participants in training programmes rose by almost 16,000 over the same period (Stiglbauer 2010: 28). Following the trajectory of the crisis, job losses first appeared in the manufacturing sector, with losses in February 2009 outstripping employment gains for the first time in six years. Over the course of 2009, employment in manufacturing fell by 6 per cent (Scheiblecker *et al.* 2009: 369). Other sectors also cut employment with

the effect that the pace of reduction increased until the third quarter of 2009, when total employment slumped by 1.9 per cent (ibid. 361).

Unemployment increased quickly and at an increasing pace until June 2009 when 33 per cent more unemployed persons were registered than in the preceding month. Overall, unemployment increased by 48,100 persons or 22.6 per cent from 2008 to 2009. In terms of registered unemployment, the unemployment rate increased from 5.8 per cent in 2008 to 7.2 per cent in 2009 (ibid. 366). If people in training and other labour market service measures are included, unemployment reached 9.6 per cent in 2009 (ibid. 368). In Eurostat terms, unemployment accounted for 4.8 per cent in 2009 and was therefore significantly lower than in most other European countries (ibid. 366). Given the impact of the crisis on the manufacturing sector, men were more frequently affected by unemployment than women. Particularly affected, too, were young workers, migrants and semi- or unskilled workers (ibid.). The average duration of unemployment increased during the crisis, as did the proportion of long-term unemployed persons (ibid. 368).

Among the first workers who lost their jobs were temporary agency workers. The number of agency workers increased significantly during the economic boom preceding the crisis, but declined by 15.9 per cent between July 2008 and July 2009; in manufacturing the reduction amounted to 32.8 per cent over the same period (ibid. 365). Employment cuts in manufacturing and in employment agencies combined were as big as in the rest of the economy put together (Stiglbauer 2010: 28). However, agency workers were not only the first to be laid off. They were also the first to be re-hired after growth started to pick up again in the second half of 2009 (Allinger 2011). Permanent employment also started to bounce back in 2010, but by the end of 2010 the manufacturing sector was still lacking 56,000 jobs compared to the peak of employment in mid-2008 (Marterbauer 2010: 922).

3. Responses to the crisis

3.1 Fiscal policy

In the face of the crisis, Austria, like many other countries in Europe and around the world, temporarily returned to Keynesian deficit-spending. As a first measure the government adopted a generous rescue package for

the Austrian banks. The government pledged to inject up to 100 billion euros into the banking system, if needed. The rescue package was extremely generous relative to the size of the country and reflected the enhanced exposure of Austrian banks in Central and Eastern Europe. Of the 100 billion, only 7.3 billion were actually used. In addition to saving banks, the government also adopted two economic stimulus packages to help the struggling economy. The volume of the package was 12 billion euros, or 3.5 per cent of GDP (Breuss, Kaniovski and Schratzenstaller 2009; Berger *et al.* 2009). The main stimulus came from tax cuts for households and tax credits and subsidies for companies. A major tax reform which was initially planned for 2010 was brought forward and adopted in 2009. The tax giveaways accounted for 2.1 per cent of GDP, although they benefited mainly high earners. Households in the first four income deciles gained less than households in the tenth income decile (*ibid.* 36). In terms of expenditure, stimulus money went mainly to the modernisation of railway infrastructure and road construction. Investments in social infrastructure included the introduction of a cost-free kindergarten year for children before they start school, but in sum they were fairly marginal. Deficit-spending, in other words, followed the traditional spending path and barely promoted structural change or social innovation. Part of the stimulus package was also a 22.5 million car wreckage premium.

As a result of deficit-spending, the yearly deficit (according to Eurostat figures) increased from 0.9 per cent of GDP in 2008 to 4.1 per cent in 2009 and 4.6 per cent in 2010; the total deficit increased from 63.8 per cent of GDP in 2008 to 69.9 per cent in 2009 and 72.3 per cent in 2011 (partly because of changes in deficit calculation). In order to tackle the growing deficit, the government adopted an austerity package in 2011, totalling 6.3 billion euros (Schratenstaller 2011). Except for a special tax levied on banks in exchange for the support they received during the crisis, the major part of the additional revenues come from consumer taxes (on cigarettes, gasoline, air tickets and so on). This means that lower income households contribute a significantly higher proportion of their income to the fiscal consolidation than high income households. Low income households also suffer from cuts in welfare spending, including cuts in care benefits and family allowances. Other areas particularly affected by spending cuts include education, research, and art and culture. Overall, the cuts follow a traditional pattern, mainly affecting those who are most vulnerable and aggravating rather than

alleviating social problems. Cuts in research and education are particularly problematic given Austria's poor record in both fields.

3.2 Labour market policy

The government adopted a number of measures against the growth in unemployment, pooled in two labour market packages. The most popular measure was the reform of short-time working. The reform was based on a social partner agreement, underlining the role of the social partners in mitigating the effects of the crisis. Short-time working existed before the crisis but played only a minor role. Among other things it was used to help companies affected by environmental disasters. In October 2008, right before the outbreak of the crisis, 400 workers were registered as taking part in short-time working schemes (BMASK 2010: 300). From the social partner perspective, short-time working is particularly attractive since it helps to retain qualified staff and avoid unemployment, while most of the costs are covered by government. No wonder the social partners quickly agreed to a reform, making it easier for companies to apply for short-time working and improving support (Hermann 2011).

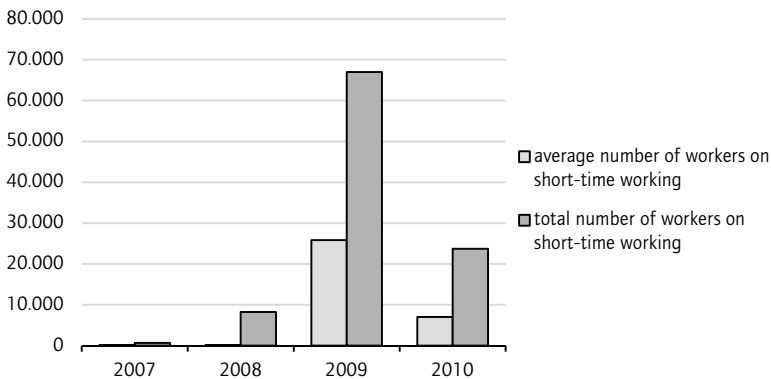
The reform was based on two amendments of the existing regulations. The main improvements concerned an extension of the short-time working period, first to 18 and then to 24 months. At the same time, the proportion of short-time working was extended to any number of hours between 10 and 90 per cent of regular working time (BMASK 2010: 293–94). The reform also introduced a rebate for employer social security contributions after six months of short-time working and special financial incentives for companies which combine short-time working with training or further education (*ibid.*).

Further details of the introduction of short-time working were regulated in an inter-sectoral framework agreement negotiated between the Chamber of Economy and the Trade Union Federation (Allinger and Flecker 2010; Hermann 2011). Austrian companies also need a company agreement signed by a works council and a trade union representative if they want to switch to short-time working. The two main unions representing workers in the industrial sector (PROGE and GPA-DJP) agreed that they would sign company agreements only if the affected workers receive 90 per cent of

their regular wages, regardless of how many hours they were working. Since about 60 per cent of wages was covered by the Labour Market Service (the rate for unemployment benefit), the rest had to be paid by the companies. Except in a number of small and medium-sized companies the unions were mostly successful in obtaining the 90 per cent replacement rate. While the social partner negotiations on the short-time working reform ran fairly smoothly, introduction on the company level occasionally sparked conflicts (Hermann 2011).

Short-time working is widely considered a success. It was used mainly in automobile production and by auto suppliers, as well as in engineering and the metal sector more generally. At the peak of development in April 2009, more than 300 companies had introduced short-time working affecting more than 37,000 workers (BMASK 2010: 300).

Figure 1 Development of short-time working in Austria, 2007–2010



Notes: Average number is based on the average of 12 reporting days distributed over the whole year. Total number is the total number of workers registered as working short-time during the same year. Since most short-time working periods are shorter than a year, the total number is significantly higher than the average rate.

Source: Federal Ministry of Employment, Social Affairs and Consumer Protection.

The Federal Ministry of Employment, Social Affairs and Consumer Protection estimates that short-time working saved approximately 30,000 jobs (BMASK 2010: 304). Alfred Stiglbauer (2010: 35), however, estimates that the effect was much lower. Assuming that 26 per cent of the 26,000 employees on short-time working would have lost their jobs – 26 per cent was the average reduction of time in short-time schemes – he

calculates an employment effect of just under 6,800 or 0.2 per cent of total employment. Stiglbauer (ibid.) argues that short-time working made up only a small part of the total reduction in working hours during the crisis.

Interestingly, companies actually introduced short-time hours for only 64 per cent of those workers who were pre-registered with the Labour Market Service for short-time working (the authorities had to be informed six weeks before the introduction of short-time working and four weeks before an extension). Hence in the end the measure was less widespread than expected by the government. Of the 220 million euros reserved for short-time working slightly more than half was actually needed (BMASK 2010: 300). Taking into account the different sizes of the two countries, short-time working was less frequently used in Austria than in Germany (Bock-Schappelwein, Mahringer and Rückert 2011: 45). However, some argue that the very availability of short-time working had a positive effect on the stabilisation of employment during the crisis (Wagner-Pinter 2011: 8).

While short-time working is considered a success, the combination of short-time working and further education was largely a failure. Only 20 per cent of workers on short-time working used the opportunity to improve their skills (ibid.). One reason may be that the additional incentives were targeted towards companies instead of workers (many of whom already received 90 per cent of their regular wages). Another reason is that qualifications typically need long-term planning, whereas the crisis required ad hoc action. Perhaps the gloomy economic outlook was also not very encouraging when it came to investing in a job that may no longer exist after the crisis (Bock-Schappelwein, Mahringer and Rückert 2011). In any case, while workers were reluctant to combine short-time working with further education, many took the opportunity and went on educational leave: 6,900 workers were on educational leave at the peak of development in November 2009. This was six times more than in November 2007 (BMASK 2010: 302).

3.3 Wage policy

For a number of years real wages have increased only very moderately in Austria, clearly lagging behind productivity growth. Even at the height of the recent expansion in 2007 a nominal wage hike of 2.5 per

cent turned into a real wage increase of 0.3 per cent. Interestingly, the crisis year became a major exception in this long-term development. In 2009, real wages soared by an astonishing 2.9 per cent, which was as much as in the preceding eight years put together. Of course, the main reason for the boost in real wages was the fall in inflation (from 3.2 per cent in 2008 to 0.5 per cent in 2009), but even in nominal terms wages increased more during the crisis year than during the preceding boom (Hermann 2011). In terms of both nominal and real wage growth Austria was among the leading countries in Europe, ranked above countries such as Sweden and Germany. In fact, 2009 was the only year for a long time when wage growth actually exceeded the combined growth in average prices and productivity (Schulten 2010: 198). The growth in real wages was instrumental in sustaining demand during the crisis and together with the tax cuts compensated for the dramatic fall in exports..

However, with the exception of the public sector where the government agreed to an exceptionally high wage increase to maintain purchasing power (3.55 per cent nominally and 3.5 per cent in real terms in 2009), the growth in (real) wages was not necessarily the result of social partner consent and a common strategy to confront the crisis (*ibid.*). In several cases the negotiations were particularly tense and temporarily broke down, especially in the spring 2009 bargaining round. The unions repeatedly had to mobilise works council representatives and members to increase pressure on employers to accept wage increases despite the accumulating economic difficulties (as a first step to a possible industrial dispute unions usually organise a national works council meeting and then hold so-called consultation meetings with members in major companies).

The substantial real wage growth was a combination of several factors. First of all, Austrian trade unions traditionally base their wage demands on the development of the past twelve months rather than future projections and the numbers for 2007–2008 showed particularly high growth and high inflation (most agreements are negotiated on a yearly base); second, due to a split in the autumn and spring bargaining rounds it was only the spring 2009 bargaining round which was fully affected by the crisis, whereas in autumn 2008 and autumn 2009 the situation was gradually deteriorating or already improving; third, the crisis was relatively short (*ibid.*). Because of the short duration the very moderate 2010 wage increases gave the whole policy an anti-cyclical

effect. A nominal wage increase of 1.4 per cent in 2010 turned out to be a real wage loss of 0.3 per cent. This would have been a major blow to demand-led growth if the crisis had continued. Given the return to fairly moderate wage agreements it looks as if 2009 was an exception rather than a turning point in Austrian wage policy (*ibid.*).

3.4 Working time

Austria has among the longest contractual and actual working hours in Western Europe. Working hours fell significantly during the crisis but many workers continued to work overtime. According to Labour Market Survey data, average weekly overtime hours fell from two hours in 2008 to 1.7 hours in 2007. Both capital and labour referred to the experience of the crisis and called for changes in working hours. However, while the employers' organisation advocated further flexibilisation – including an extension of the averaging period from one to two years and a topping-up of overtime accounts to a maximum of 150 hours – the trade unions argued for a reduction of working time and the distribution of work among a larger number of workers (Allinger 2010; Hermann 2011). It was the employers who started the discussion in the autumn 2009 bargaining round with the effect that a wage agreement could be reached only after the employers agreed to separate negotiations on working time to be held in spring 2010. In autumn 2010 it was the unions that took the initiative and demanded shorter hours at the beginning of the negotiation process. In both cases the negotiations were terminated without an agreement (*ibid.*). The positive aspect is that working time reductions were at least temporarily on the political agenda and there were few other countries in Europe where this was the case. The negative aspect is that the social partners could not reach an agreement and that working hours, as a result, remained long.

4. From crisis to recovery

After the contraction in 2009, the Austrian economy started to grow again in 2010. GDP grew by 2 per cent in 2010 and the Austrian Institute for Economic Research expects a 2.5 per cent growth in 2011 (Eder 2011: 220). The growth was driven by a strong recovery of export industry, mainly fuelled by the German recovery and by growing

exports to the newly industrialising countries, especially China. Production in the industrial sector increased by 6.7 per cent in 2010 and is expected to grow another 7 per cent in 2011, after falling by 14.3 per cent in 2009 (ibid. 226). However, employment in the production sector has further fallen by 1.3 per cent in 2010, indicating that companies rely on overtime and agency workers rather than hiring additional permanent staff (Scheiblecker *et al.* 2011: 256). After a prolonged period of stagnation, investment in production has picked up again in 2011. While the export sector has largely recovered, the construction industry is still struggling with sluggish demand (Eder 2011: 227). Real terms growth in household demand, which partly compensated for the loss in exports, fell back to 1 per cent in 2010 (after increasing 1.6 per cent in 2009). Unemployment fell to 6.9 per cent in 2010 and is expected to reach 6.4 per cent in 2012 (Eurostat: 4.4 per cent and 4.1 per cent, respectively) (ibid. 229; Scheiblecker *et al.* 2011: 278 and 293).

While the manufacturing sector has weathered the crisis at least temporarily, public spending during the crisis was compensated by the adoption of a first austerity package in late 2010. The austerity measures are supposed to save 15.5 billion euros by 2014 (Schratzstaller 2011). The cuts in welfare state spending, including care benefits and cuts in research, education and culture may have some negative effects on public employment, but nowhere near the negative effects of the austerity packages adopted in the United Kingdom, Ireland or Greece.

5. Long-term effects and unsolved problems

Austria has weathered the crisis relatively well. The recession was deep but short and growth resumed mainly thanks to the recovery of demand for exports, especially to Germany (whereas the construction industry continues to struggle). Austria has done fairly well also because of the adoption of a number of crisis measures which temporarily broke with what can broadly be described as mainstream neoliberal policy. In the wake of the crisis the government adopted two economic stimulus and two labour market packages, promoting demand-led growth and subsidising the preservation of employment. The government even went as far as nationalising two failing banks, one of them among the six largest financial institutions – even though, of course, this was more

of an emergency measure than a policy change. Demand was also fuelled by a series of extraordinary real wage increases adopted in the midst of the crisis after years of very moderate real wage growth. Together the growth of household consumption partly set off the export losses. Social partnership played a major role in developing the policy response and mitigating the crisis: the social partners not only negotiated extraordinary wage increases, but were also heavily involved in negotiating the short-time working reform and adopting short-time working on the company level. To some extent the crisis led to a revival of Austrian social partnership.

However, most of these measures ended as soon as growth started to pick up again and Austria quickly returned to the pre-crisis paradigm. The stimulus was followed by an austerity package adopted in 2011, while real wages fell by 0.3 per cent in the same year. Both had a negative impact on household consumption. After the nationalisation of failing banks, conservative politicians called for the privatisation or sale of the remaining state assets in what previously were public companies (especially the lucrative electricity companies). The recovery rendered the Austrian economy even more dependent on German growth. If anything, the crisis has reinforced pre-existing trends which made Austria increasingly vulnerable to external shocks. The situation in Central and Eastern Europe is calm for the moment, but given the economic imbalances in Europe, which are far from being solved, the situation can change at any moment, putting the Austrian banking system and Austrian finances at risk.

Given the nature of the stimulus and austerity packages there is very little hope of a revitalisation and extension of the welfare state in order to counter the continuing discrimination against women and low-income earners built into the conservative welfare state model. When demand picked up again employers in manufacturing relied heavily on temporary agency workers. It is also likely that they will further increase the number of part-time workers, while at the same time demanding more working time flexibility. The welfare cuts have aggravated rather than solved some of the most pressing social problems, including the organisation of long-term care or the labour market integration of disabled workers. Continuous austerity, furthermore, undermines any vision of an active and supportive public sector promoting equality and well-being.

Overall, the particular political handling of the aftermath of the crisis had the effect of reinforcing those tendencies that had already changed the Austrian model quite considerably before 2008. Again, the institutions of social partnership not only helped the country to face the recession, but by integrating labour's interest representatives in policy-making they also turned out to be conducive to implementing austerity measures after the crisis. The grand coalition government has blocked attempts to increase taxes on capital and private wealth, for example on so-called private foundations that enjoy particularly low tax rates. Given the comparatively very low property taxes, even the OECD recommends a 'review of capital taxation' (OECD 2011: 26). Because of the one-sided tax system, it has not been possible to spread the costs of the crisis more evenly and to raise funds for overdue investments in education, research and care. While Austrian institutions have been helpful in rapidly developing and implementing anti-crisis measures, in doing so they followed path-dependencies and failed to adopt future-oriented measures. Nothing noteworthy has been achieved in either research funding or energy saving. Problem-solving capacities were thus limited to the short term and seem unable to cope with the major challenges of today. As in other countries, what caused the problems in the first place are still being called for or actually used as remedies: austerity, privatisation and protection of financial assets. The increased public debt and the determination to reduce it make it unlikely that Austria will get off as lightly in the event of a new recession.

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Hungary's full-blown malaise

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1. Introduction

At the end of 2007, we noted that Hungary was in a state of malaise and uncertainty concerning whether the country was on the right development route (Neumann and Tóth 2009). Four years later, Hungary is suffering from a full-blown malaise. Although Hungary is entering the sixth year of the economic crisis provoked by the accumulation of debt by the state and the private sector, it seems that the worst of the ordeal still lies ahead. The signs of this malaise are everywhere. More and more Hungarians are losing their faith in political parties, institutions, democracy and even the market economy. Opinion pages in newspapers are arguing that Hungary has become a colony of international finance. The far right is on the rise and a new exodus of Hungarians in search of a better future in rich Western European countries has begun.

In this chapter we argue that Hungary – and indeed many of the new member states in Central and Eastern Europe (CEE) – has had no luck at all. It escaped too late from the iron cage of Soviet-style socialism and the grip of the Soviet Union. The short period of growth after the destructive years of the post-socialist crisis was not enough to bring about more generalised growth before the outbreak of the debt crisis.

At the same time, the expectations of the population were too high, partly induced by the (comparatively) high standard of living in the old EU member states and partly by the illusions created by EU accession. The rising tension between high expectations and uneven development undermined political stability and opened the door to political populism around 2000. The special conditions of the early 2000s, when easy money led to a build-up of debt, allowed illusionary economic growth boosted by populist expansionary government policies. The accumulation of both government debt and private debt masked the problems being

generated by an unsustainable economic path. The debt build-up sent distorted signals to the political sphere and the population and created a rosy illusion. From 2000 onwards, half a decade of debt creation fuelled illusionary growth, which ended in 2006. Since 2006, Hungary has been stumbling from crisis to crisis.

The debt-induced crisis of the real economy began in Hungary well before the advent of the credit crunch. Unfortunately, the home-made crisis coincided with the outbreak of two major crises at the end of the first decade of the 2000s. First, the debt crunch in autumn 2008 and the following Europe-wide crisis induced by similar debt build-ups and political illusions about the common monetary system. Second, the ongoing employment and demographic crisis – highlighted by the debt crisis – which calls into question the sustainability of the welfare state model that Hungary adopted. These interrelated crises are feeding each other and pushing the country deeper and deeper into a whirlpool.

The turning of the tide caught an inattentive society by surprise. The long and ever deepening crisis has crushed the illusions of the transition period. The dreams related to the European social model and a globalised market economy are in ruins for a very large segment of Hungarian society. Illusions have been replaced by disillusion. Hungary, again, is in a new transition process after the transition from socialism towards a new model.

The aim of this chapter to analyse how these factors have coincided and fed the accumulation of causes of the crises and to describe the direction in which Hungary is heading.

2. The hope and demise of the Hungarian model

Hungary escaped from the iron cage of Soviet-style socialism and the grip of the Soviet Union in 1989. Had the change of system occurred some time in the mid-1970s, when Spain and Portugal turned towards democracy and slowly opened up their economies, Hungary would have had time to adapt in a more piecemeal manner to the competition between open markets within Europe and, indeed, to the emerging globalisation. But this was not to be. The transition took place as the world was entering the triumphant years of globalisation and the dominant discourse was

in praise of unfettered competition. For Hungary this took the form of a policy imperative to open up the economy and to demolish customs barriers. During the political transition in 1988–89, most domestic actors did not foresee the coming destructive force of globalisation. Instead, it was hoped that emerging small and medium-sized enterprises, emerging from the micro-entrepreneurial seeds of the Kadarist semi-marketised socialist system, would quickly make use of the freeing of the economy from state control and create a flourishing economy. It was hoped that this domestic SME-based economy would be similar to that of Germany's *Mittelstand*. It was hoped that such a development would allow the phasing out, step by step, of the state-owned industrial sector and would make possible a new development path without too much social conflict.

Reality turned out to be different. State-owned domestic industry, which was accustomed to the monopolistic internal market of the Soviet bloc, was technologically outdated and work organisation and business practices were hopelessly uncompetitive as companies produced for non-competitive monopolistic markets. In 1990, Hungary was exposed overnight to the ruthless competition of a globalised world. The impact of unfettered competition was exacerbated by the collapse of the monopolistic Soviet markets. The passing of a very strict bankruptcy law made things worse and speeded up the collapse of state-owned companies. Thus, opening up, in the first instance, was a destructive force in Hungary (Lorentzen, 1995). State-owned large-scale domestic industry was practically wiped out. Only those companies survived the 'great extinction' which were bought by strategic foreign investors or served the more closed niche markets dominated by government procurement. The disbanding of agricultural cooperatives induced a similar job crisis in rural Hungary. The great extinction of large companies and cooperatives was also a major social catastrophe. In the first years of the transition more than 1 million jobs were destroyed out of 4 million. Large segments of society were pushed out of the labour market into welfare dependency, especially older generations, Roma or the under-skilled rural population. The newly emerging strata of welfare recipients formed a new burden on the state budget.

As far as the SME sector is concerned, it quickly became clear that the 40 years of the Soviet system had left a population short of the capital and business knowledge necessary for the endogenous building up of a

successful market economy based on starting up firms from nothing. The rebirth of a domestic small and medium-sized enterprise sector, which began to flourish after 1989, was only a partial success. Although hundreds of thousands of SMEs were set up, most were micro-enterprises serving the domestic market at a very low productivity level. A large segment of this sector could survive only by operating at least partly in the shadow economy, employing partially or fully undeclared workers and evading taxes. Estimates suggest that the share of the shadow economy could be as high as one-third of the total economy.

It was left to foreign direct investment to export capital, modern technology and best practice business models into Hungary. The FDI-based development route was especially feasible as the semi-open character of the Kadarist regime had allowed some contact with the Western world from the 1970s onwards, which laid the foundations for Hungary to develop an FDI-based renewal of Hungarian industry. Hungary was also in dire need of external capital as the country inherited a 90 per cent debt level from the previous regime. It was an absolute necessity to induce export-oriented development through FDI to avoid bankruptcy. Hungary, which turned to FDI almost alone in Central and Eastern Europe just after the transition, was extremely successful in attracting foreign investors in the 1990s. Hungary became the favoured destination of FDI in Central and Eastern Europe: in 1997, per capita foreign investment in Hungary was three times larger than in Poland or the Czech Republic. Manufacturing FDI by strategic investors was a very important part of the incoming investment stream. As a consequence of FDI-based manufacturing renewal, Hungary was successfully turned into a manufacturing base for export-oriented manufacturing. Largely, due to this export-oriented FDI, the Hungarian economy became interwoven with the European economic area. Already in 1997 two-thirds of Hungarian exports and imports were with Europe. Nonetheless, one of the by-products of the large inflow of capital was that certain economic sectors became dominated by foreign owners. Also, most of the flagship companies of the Hungarian economy became foreign-owned firms. This foreign dominance also led to a political backlash: the FDI-based economic strategy was politically vulnerable in times of crisis.

After a short recovery in 1993, which followed a crisis provoked by the collapse of the Mexican peso, and after two years of painful reforms, Hungary returned to sustained growth in 1996, which lasted uninterrupted

until 1999, when the effects of the Russian crisis hit Hungary and again slowed down the economy.

The FDI-based recovery of the economy also had positive political implications. The economic upturn and the success of economic integration into Europe strengthened pro-European sentiments and contributed to the consolidation of Hungarian democracy. Rapid integration and the harmonisation of Hungarian institution-building with that of Europe led to EU accession in 2004 (Agenda 2000).

The economic slowdown of 1999/2000, however, coincided with significant changes in overall trends. Hungary lost its prime destination status and had to accustom itself to the slowdown of FDI inflow around the turn of the millennium. This slowdown had a number of reasons. One very important factor was that the emergence of Hungary as a possible FDI location coincided with the emergence of China as one of the world's major manufacturing hubs. Low-cost Chinese competition posed a serious challenge in many labour-intensive assembly-type branches. Also, there was a change in Hungary's situation in the late 1990s compared to other Central and East European countries. While in the early 1990s Hungary was almost alone in pursuing an economic policy based on attracting FDI in the region, in the mid-1990s neighbouring countries began to follow suit. Thus new competition emerged in the region for FDI projects, capital, technology and jobs. Some of the new competitors had considerable advantages over Hungary. Poland, for example, had a very large internal market, while Slovakia and Romania competed for FDI with considerably lower wage costs (Sass 2004). In the short term, this new found competition had a negative effect on Hungary. FDI inflow into the region became more dispersed, and FDI inflow into Hungary and Hungarian economic growth slowed down.¹

The slowdown coincided with and contributed to a turn in Hungarian economic policy. The root of the change can be found in the changing sentiments of the population following years of rapid growth and the

1. Nonetheless, in our opinion, the recovery of the region as a whole and the emergence of cross-regional manufacturing networks do offer Hungary positive long-term prospects and reinforce the basis for specialisation by the region and, within it, Hungary as a base for a manufacturing hub within the European economic area.

palpable possibility of EU accession after joining NATO in 1999. Hungarians wanted to experience the dividends of growth in a rapid elevation of living standards and wages, converging with Western European levels. 'Real harmonisation' was the key word in public debate after institutional and legal harmonisation in the course of adopting the EU's *acquis communautaire*. FIDESZ, which was elected in 1998, had pursued a prudent economic policy under the leadership of Viktor Orbán. In 2000, however, the government, reeling from a loss of public support following the slowdown of the economy, turned to Keynesian-style state financed economic development by boosting consumption. It was hoped that growth in domestic consumption would kick-start the Hungarian economy to resume growth and would also help to regain political support for FIDESZ. Various measures, such as a 60 per cent increase in the minimum wage between 2000 and 2001 in two steps, a 75 per cent wage increase for civil servants within a short time-span and a generous mortgage support programme to boost flat construction marked this new policy.

This policy change was not successful in securing electoral victory in 2002 for FIDESZ, but it definitely put Hungarian economic policy onto a new track. In the heated 2002 election campaign, MSZP, the major opposition party, campaigned with the slogan 'welfare system change' and outbid the governing FIDESZ by promising large-scale welfare and other measures, such as a 50 per cent wage increase for public sector employees, a thirteenth-month pension payment to all pensioners, abolition of income tax for low wage employees and an ambitious road construction programme. Winning the election in 2002, MSZP implemented all the headline pledges made in the election campaign. Expansionary state spending returned Hungary to rapid economic growth, but at a price: a high budget deficit and accumulating debt.

In 2003, the MSZP government led by Péter Medgyessy tried to reduce the budget deficit and the rising debt. The policy change was also influenced by the EU. The accession agreement stipulated that Hungary would join the Eurozone and Hungary was obliged to comply with the thresholds established by the European Stability Pact (ESP) for a low budget deficit, inflation rate and debt level. This imperative required an economic policy aimed at reducing the state budget deficit and overall debt level. Economic measures initiated in 2003 to redress imbalances in the state budget, however, led to a rapid loss of popularity for the govern-

ment. FIDESZ, the major centre-right party in opposition, led by the charismatic Viktor Orbán, increasingly embraced a populist and nationalistic tone and opposed any state-budget consolidation efforts. FIDESZ campaigned for a strong development state model, which supposedly would ensure the welfare and well-being of Hungarians. In autumn 2004, facing the possibility of losing the election in 2006, MSZP opted to change the head of government and nominated Ferenc Gyurcsány, a young, more charismatic figure. Although the European Commission repeatedly asked the Hungarian government to follow a prudent economic policy, Gyurcsány, aiming to win the 2006 election, adopted a populist tone and returned to debt accumulation to finance the rapid increase in domestic consumption spurred by the state budget measures. This government policy was made possible by the special conditions of the early 2000s, when abundant cheap credit inundated the world. Easy debt seemed to allow Hungary to follow an economic policy based on an expansionary state budget policy. This process facilitated a boom in construction and the launch of large-scale infrastructure projects. On the other hand, rising prices undermined the economy's ability to attract manufacturing FDI.

Populism was on the rise on both the left and the right. In the run-up to the 2006 elections both camps campaigned on ever increasing welfare measures and promised large-scale state development projects. In a last ditch effort to ensure electoral success, in late 2005 the government implemented new expansionary measures which sent the budget deficit north of 10 per cent in 2006. Creating the illusion of never-ending growth by means of expansionary policies was the order of the day. The large public deficit and rising debt, however, were criticised several times by the European Commission. The Commission demanded a more prudent economic policy in accordance with the ESP. After several warnings, the Commission rejected Hungary's 2005 Convergence Programme, submitted by the Gyurcsány government, and made it clear that after the elections, in autumn 2006, the Hungarian government would have to put forward a new convergence programme.

MSZP easily won the 2006 campaign, painting the picture of an ever-growing 'Pannon puma' and a rosy future for all. After winning the election, however, Gyurcsány had to meet the EU's demand to come up with a realistic Convergence Plan, which entailed a severe cut in budget spending after the fiscal profligacy of 2002–2006. The government's

sudden U-turn was a bolt from the blue for most Hungarians. Things were made worse by the leaking of a speech given by the Prime Minister in autumn 2006, in which he admitted to a closed meeting of the MSZP's parliamentary faction that the government had lied during the election campaign, did not govern properly and had forged statistical data to mislead the electorate in order to win re-election. The leaking of the speech led to an eruption of protests throughout the country. FIDESZ accused the government of winning the election under false pretences and demanded a new election. The Gyurcsány-led government, however, refused to accede to the demands of the opposition. It hoped that a sharp correction and rebalancing of the budget would cut the recession short and lead to growth from 2008 onwards, thereby hopefully restoring the government's fortunes.

In early 2008, the Hungarian economy seemed to return to growth after an anaemic 2007. However, in autumn 2008 the credit crunch hit. The ensuing financial crisis forced Hungary to turn to the IMF and to begin a new round of drastic economic austerity measures to reduce the budget deficit. At the same time, the export-led engine of the Hungarian economy came to halt: 2009 saw a 6.7 per cent fall in GDP, mainly due to the worldwide recession. The collapse of the Hungarian economy was especially deep as the state, after years of pro-cyclical spending drift, had to continue to cut budget spending instead of initiating Keynesian-style anti-cyclical measures to lessen the impact of the recession in the real economy.

The crisis also shed light on the unsustainable employment and demographic trends of Hungarian society. Hungary, after the collapse of the state-owned industrial sector, emerged as a country with a substantial inactive population, partly due to the relatively generous early pension and disability schemes, which allowed older people to opt to be welfare recipients instead of being unemployed. A huge segment of the Hungarian active population is unable to find work due to health problems related to age, but also poor education and living in remote rural areas. The rapid aging of the society made things worse. The Hungarian population, and that of the working age population, is both shrinking and greying. This parallel process is increasingly imposing an unsustainable burden on the welfare budget, especially as far as pension payments and health costs are concerned (Hugh 2007; Fazekas, Cseres-Gergely and Scharle 2008).

The new round of the crisis has used up the gains of the rebalancing efforts of the 2006–2008 period and sent the economy into a new decline. This negative turn completely undermined the political credibility of the government and of MSZP in particular, which was already in a deep legitimacy crisis due to the economic U-turn after the 2006 election and the leaked ‘we were lying day and night’ speech. Finally, the outbreak of a series of corruption scandals further eroded public support for MSZP. The relentless opposition of FIDESZ also hindered the government in making it clear that some of the reforms were necessary and not merely government malevolence.

The 2010 elections were won by FIDESZ by an overwhelming majority, while Jobbik (from the party’s original name *Jobboldali Ifjúsági Közösség* or Right-wing Youth Association), the far right party, won 16.7 per cent of the votes with an economic programme directed against the market economy. The MSZP, which four years previously had easily won the elections, gained less than 20 per cent of the votes.

3. The crisis and the ‘conservative revolution’

The misguided economic policy of the early 2000s also sent false signals to the population. It seemed that sustainable and rapid economic expansion, the rapid increase of living standards and the ongoing ‘real’ harmonisation with more established EU member states would ensure an ever growing income stream for Hungary. The first Orbán government of 1998–2002 initiated a lavish mortgage subsidy programme to boost the construction industry after it had decided to boost the economy by expanding government spending in 2000. In 2001, it allowed banks to offer foreign currency mortgages and loans for Hungarian citizens. Austrian banks pioneered this technique in Hungary and had begun to offer Swiss franc-based loans to Hungarian citizens to gain market share. Until 2003, the share of Swiss franc-based loans was minimal compared to forint-based loans. Nonetheless, around 2003, four factors changed the state of play. After the elections, the Hungarian National Bank (MNB) initiated a policy of raising the base interest rate of the Hungarian forint in response to the government’s public spending-based expansionary programme in order to reduce inflationary pressures. As a consequence, the price of Hungarian forint-based loans shot up, while the value of the forint strengthened against the euro and the Swiss franc. Additionally,

in 2003 the Medgyessy government, as part of the budget stabilisation programme, terminated the subsidisation of forint-based mortgages launched by the Orbán government. Moreover, after EU accession in 2004, there was a consensus among the political parties that Hungary should join the Eurozone as soon as possible, but not later than the end of the decade. The possibility of rapid accession to the Eurozone also made foreign currency-based loans seem relatively safe. As a consequence, such loans expanded rapidly from 2004 onwards. Despite several warnings, the Gyurcsány government, possibly fearing the recessionary impact of the drying up of credit flows, did not change the law. Thus, the build up of debt in Swiss francs in the private sector went on uninterrupted until the outbreak of the credit crunch in late 2008. The volume of private sector debt in foreign currency reached 20 per cent of GDP.

The worldwide financial crisis which broke out in 2008 made it clear that indebtedness in Swiss francs was a major source of risk not only for individuals, but for the whole economy due to the rapid loss of value of the forint and the rise of the Swiss franc against the euro. The rapid loss of value of the forint against the Swiss franc created a burden on the Hungarian middle class with loans in that currency. The rapid increase in mortgage payments in forints sent consumption plunging, hurting the domestic economy, while the increasing proportion of defaults posed a systemic risk for the banking sector.

In 2008, it became clear that Hungary was under threat from a double indebtedness: of both the state budget and the population. Having to cope with two deleveraging processes created a perilous situation because each would require the opposite medicine. The recessionary impact of cutting the budget deficit in an economy in recession hurts the real economy and household incomes and causes real private debt inflation compared to private revenues. The increased mortgage payments had a negative effect on consumption, which meant shrinking state revenues, consequently inflating the budget deficit. The two parallel deleveraging processes fed each other, risking a possible debt crisis and posing a huge challenge to government policy.

Moreover, the Swiss franc-based debt burden created an economic policy Catch 22. In the context of stagnating or even decreasing domestic consumption, only growth in export-oriented manufacturing would allow Hungary to escape the debt trap. Given the loss of

competitiveness in the first half of the decade due to the strengthening of the forint against the euro and rapidly rising wages, the return to a lower exchange rate for the forint² and internal wage deflation seemed necessary to restore competitiveness and make Hungary attractive to strategic investors. Household debt in Swiss francs and the strengthening of the Swiss franc against the forint and the euro in the wake of the crisis, however, effectively tied the forint to a reserve currency and means that the forint cannot fall too low and effective domestic wage deflation is not possible without risking social catastrophe and major turbulence for the banking sector.

Before 2010, FIDESZ took a populist stance in opposition and resisted any government attempt to restore budget soundness, promising a strong state and the resumption of state budget-induced growth. In 2010, however, the deepening crisis and the insistence of the EU on a low budget deficit (3 per cent for 2011 and 2.5 per cent for 2012) effectively blocked FIDESZ's initial plans to initiate an anti-cyclical expansionary exit from the crisis. FIDESZ in government has to continue the painful deleveraging process, as the European Commission has made it clear that it will not accept any other option.

FIDESZ's two-thirds parliamentary majority, however, ushered in a new political situation. It allowed the government to throw off constitutional constraints as constitutional amendments are possible with a two-thirds majority in Parliament. The government declared that its goal is to reorganise Hungary in a 'revolutionary' transformation period. The overwhelming majority enjoyed by the government parties was used, first, to create a new legal order, which aimed to eliminate checks and balances with regard to the government, which might have blocked the revolutionary transformation. The re-regulation of the media law, the limitation of the scope of jurisdiction of the Constitutional Court and the new constitution, the Basic Law, were all aimed at reinforcing the government's grip on the country. The reshaping of the institutional order of industrial relations is also aimed at limiting the influence of independent institutions. The government disbanded the standing

2. It is widely held that the pre-crisis 230 forint/euro exchange rate was far too low for export-oriented industries, while the strong forint boosted imports for consumption.

tripartite body with its statutory rights and created a new tripartite-plus consultation forum, with the involvement of NGOs and churches.

It is increasingly clear that the re-organisation of the country by an omnipotent government is heading towards a new economic and societal model. The government's stated goal is to create a new more indigenous growth model based on strong government and strong domestic economic actors following the failure of the post-transition societal model. This differs from the goal of 1989, which was a liberal democracy and a social market economy with a strong universal welfare state.

The core political idea of the new order is a kind of illiberal constitutional order based on a parliamentary majority (see Lukács 2005) which makes it possible to control the government: elections are to be held every four years.

As far as the societal model is concerned, the government intends to strengthen the position of the elite and the upper middle layers of Hungarian society in order to put them in a position to ignite a new development phase based on their capital and savings and to lessen the role of foreign actors. The introduction of a 16 per cent universal flat tax, in practice, meant a substantial reduction in the tax burden of the upper 10 per cent of taxpayers, thereby substantially increasing the tax burden on the rest of society, especially for those on the minimum wage. The recent initiative to allow the repayment of foreign currency-based mortgages in one lump sum at approximately a 30 per cent lower exchange rate than the current exchange rate between the forint and the Swiss franc or euro is also beneficial for the small segment of society with sufficient savings.³

It is the government's declared intention to foster domestic economic development and help domestic companies to withstand competitive pressures with the help of a strong developmental state. Nonetheless, the effectiveness of such intentions is limited by the lack of state development funding, in particular since the economic crisis. The state, instead

3. According to government estimates, 100,000 families would have enough savings to make use of the repayment scheme out of 1 million families with foreign currency-based loans.

of pouring money into the economy, has to cope with the daunting task of meeting the budget deficit laid down by the EU (as already mentioned, 3 per cent for 2011 and 2.5 per cent for 2012). The budget requirements have forced the government to introduce successive stabilisation packages which, in effect, are reducing domestic consumption and hurting domestic enterprises, which are mostly oriented towards the domestic market. Thus, the government, while seemingly opposed to certain forms of FDI, especially in public utilities, retail and banking, does welcome manufacturing investments by strategic foreign investors and offers ample support to major players wishing to invest in Hungary. Tax holidays and state support for large foreign investors leaves a high tax burden on smaller domestic enterprises. For domestic enterprises it is especially difficult to cope with the high tax level: as a rule, their productivity is poor and they generate lower revenues.

Thus the contradictory objectives of reducing the effective tax level and, at the same time, maintaining tax allowances for those who are deemed strategically important, while cutting the budget deficit leave the government no room for manoeuvre. It has been forced to severely reduce welfare payments and cut back essential, but costly public services. The redesign also influences labour market policies: the time span for receiving unemployment benefit was reduced to three months and a work obligation in community projects has been introduced for those on welfare benefits at very low pay (around half the national minimum wage). It is also important to note that FIDESZ's redesign of labour market policy is partly driven by their social vision of creating a workfare-based society instead of welfare dependency. In other words, it is not only the need to cut costs that is shaping policy in this sector. The government also intends to reduce pension costs by eliminating early retirement schemes and by the revising pension entitlements of those who took early retirement or pensions due to disability. In public services, education and health care will suffer major cutbacks. The only area in which the government is increasing spending and welfare entitlements is the policy directed towards families with children under 18 to offset the impact of the demographic crisis.

Finally, with regard to labour market regulation, the government is also preparing a clear break with the developments of the past 20 years, which were intended to emulate the European Social Model. The draft of the new Labour Code moves away from the traditional concept of

labour legislation, which sees the main task of the Labour Code as counterbalancing the labour market weakness of individual employees. The bill is intended to approximate the regulation of employment to that of civil contracts. The new Code would allow very flexible work organisation practices. The intention is to drastically reduce the thresholds laid down in the existing Labour Code with regard to various practices and to leave as much leeway as possible for individual agreements between employee and employer. The draft would also reduce the various limitations laid down in the existing Labour Code on termination of employment, allowing employers ample room to fire employees at will. The planned elimination of various traditional stipulations governing the employment relationship is accompanied by a plan to eliminate almost completely statutory trade union rights, except the right to conclude a collective agreement at workplace level.

The remaking of the welfare state, severe cuts in universal public services and labour market governance represent a major break with the policies of the past 20 years and would create a completely new societal model in an EU member state. No wonder the prime minister is hailing all these changes as a break with the moribund European model and promising citizens a new, efficient workfare-based societal model instead of the allegedly unsustainable welfare state model. Supposedly, this will lift Hungary out of the current stalemate.

Another key issue is the secondary effects of such bold measures. Any measure may have unwanted consequences and they may cause bigger problems than the original measure was intended to solve. For example, to set off the negative consequences of an increase in the tax burden on low-wage employees, the government plans to lift the minimum wage by 19 per cent in 2012 and compel companies to apply a 5 per cent across-the-board wage increase.⁴ Such a measure, in the context of economic crisis and estimated 1–1.5 per cent growth, would certainly have a negative effect on employment, especially in low-wage industries and

4. It is important to note that the 19 per cent increase in the minimum wage aims only to offset the increase in the tax burden on the minimum wage. Until the introduction of a 16 per cent flat rate personal income tax, those on the minimum wage paid no tax and low-wage employees received a tax rebate. The 19 per cent increase in the minimum wage, however, does not offset inflation and thus means a loss in the real value of the minimum wage in 2012.

would most hurt domestic enterprises competing for the shrinking domestic market at low productivity levels. Another example is the bold measure to allow to repayment of foreign currency-based loans in one sum at low exchange rate. This measure would impose huge losses on the banking sector, while freeing around 100,000 families from the burden of an ever increasing mortgage. The banking sector losses are likely to strangle credit flows to the economy, which would have a very negative effect on the company sector that depends on the domestic banking system and does not have alternative routes to obtain loans through foreign headquarters located in other countries. The palpable hostility of the government to certain types of FDI and the frequent changes in the legal environment are also unlikely to be conducive to attracting FDI on a larger scale.

4. Conclusion

FIDESZ, which between 2002 and 2010 protested vigorously against any cut in welfare spending, has embarked on a major redesign of the welfare state to turn it into a workfare state and to cut essential universal public services.

Time will tell whether the government is able to carry out its planned remake of society within the framework of a democratic political order. The overwhelming parliamentary majority has allowed the government to avoid possible institutional roadblocks that, under the old constitutional order, could have made it possible to reverse some of its decisions. Consequently, the four-year period before the next election in 2014 will probably be sufficient for the government to carry out a major overhaul. Nonetheless, the shift towards a workfare model will hurt large numbers of voters, as it gives a clear preference for strengthening the position of the upper-middle strata of the society, while cutting back universal welfare state entitlements, public services and basic rights of employees intended to ensure stable employment relations. Furthermore, the re-organisation of the Hungarian model is occurring during a major debt crisis, which calls into question the sustainability of the model that allowed the debt build up. Moreover, the crisis is also fed by long-term labour market problems and demographic changes and the consequent welfare burden on the society.

The crisis is also one of public disillusionment with the development path Hungary chose in 1989. Thus, besides the ability of a charismatic leader such as Orbán to build up sufficient loyalty and support, there may also exist an element of tacit consent on the part of the majority in a disillusioned society which favours a reorganisation plan and many people hope that the re-organisation may indeed put the Hungarian economy back onto a sustainable path. The opposition parties still lack a credible alternative vision and also lack charismatic leaders to challenge Viktor Orbán. Hungarian society, furthermore, is very individualised, highly segmented and lacks a strong grassroots institutional network which would be able to mount effective resistance to bold measures. On the other hand, no one can be sure how Hungarian society would react, lacking institutions and without checks and balances, to the rapid remaking of the welfare state in a period of profound economic crisis, with nowhere to turn.

Time will tell whether the supposed trickle-down effects of new regulations will be more beneficial, or the unwanted negative consequences of bold measures would have stronger negative effects on the economy. And besides the success or failure of these bold measures, only time will tell whether loyalty and tacit consent or protest against reorganisation will prove stronger determinants of the public mood. At the latest, in 2014, Hungarians will have a chance to vote on whether they trust the vision of the government or not.

Hungary is in a very difficult position. Poor luck, a difficult legacy from the socialist past, poor government policies, greed, misguided policies on the part of key banks, lack of experience and errors of calculation have led to a Catch 22 situation. There is a danger that the interrelated crises will feed back on one another and plunge Hungary into a whirlpool.

In principle, Hungary could overcome the crisis by becoming a low-cost manufacturing base in the vicinity of the one of the largest consumer markets in the world.⁵ The crisis induced incentive for companies to cut

5. In our 2007 analysis we concluded that this path would be not sustainable due to increasing competition from other low-wage countries. (Neumann and Tóth 2009). The tacitly supposed alternative way, a switch from a 'low-road' to a 'high-road' path would entail massive public investment in human capital, especially education. However, given the ongoing policy of severe cuts in public services, this scenario is at present practically ruled out.

costs may represent a new chance for Hungary to attract investment based on low wages and flexible working practices. Striking out once again on the export-oriented manufacturing development path may provide the resources needed to reduce the debt to a sustainable level. However, given the extremely interconnected nature of national economies within the European economic and political system, it is unlikely that Hungary could solve its crisis alone. If Hungary is plunged into an uncontrollable crisis, while Europe itself is still stumbling from crisis to crisis may raise the stakes dramatically and dangerously. More policy coordination and accompanying funds to help countries in trouble is urgently required at European level. In the absence of such European coordination, regime competition will be exacerbated and desperate last-resort measures with who knows what consequences may pose a systematic risk to the whole European structure.

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Sovereign debt crisis: an opportunity to complete the neoliberal project and dismantle the Greek employment model

Maria Karamessini

1. Introduction

The outbreak of the sovereign debt crisis at the end of 2009 marks the collapse of the Greek socio-economic model of 1994–2008, of which high public indebtedness was a core element. In a recent article (Karamessini 2009) this period was characterised as one of difficult transition from a state-led familistic to a liberal, partly de-familialised capitalism. This 'model in transition' foundered on the rocks of the global financial crisis and EMU's structural weaknesses. Although the structural causes of the Greek sovereign debt crisis are mainly internal, it would not have occurred in the absence of the global financial crisis and in another type of monetary union. Moreover, European industrial and financial capital was a major actor in the Greek growth model and the financing of the Greek state. As also happened to other countries on the European periphery, for example, Ireland, Portugal and Spain, pre-crisis growth concealed vulnerabilities in their socio-economic models. Some of these were crucial in the failure of these models in the wake of the global financial crisis.

The sovereign debt crisis triggered the granting of a huge quantity of loans to Greece by the rest of Eurozone countries and the IMF, disbursed in instalments and conditional on the strict implementation of an economic adjustment programme whose basic goals are fiscal consolidation and 'internal devaluation'. The consecutive policy packages implemented since the beginning of 2010 have caused a deep and prolonged recession which is eroding Greece's tax and productive bases and debt sustainability and disrupting the lives of millions of people and families suffering from unemployment and successive income loss and living in precarious conditions, under permanent stress and with little hope for the future. At the same time, by severely limiting the public

sector and the welfare state and dismantling the employment model, the EAP is aimed at completing the neoliberal project in Greece, that is, the transition to a liberal model of capitalism.

In this chapter we discuss the economic and social effects of the neoliberal response to the Greek sovereign debt crisis and focus in particular on the changes it implies for the pre-crisis socio-economic model. In Section 2 we briefly describe this model and in Section 3 its initial success and the vulnerabilities that led to its collapse in its confrontation with the global financial crisis. Section 4 analyses the rationale, objectives and measures of the Economic Adjustment Programme (EAP) and its contribution to the dismantling of the socio-economic and employment models. Section 5 demonstrates the disastrous implications of the policy recipe implemented. We conclude with a discussion of prospects and alternatives.

2. A socio-economic model in transition from state-led to liberal capitalism (1994–2008)

In this section we describe the basic elements of the growth model, as well as changes in the production and welfare regimes and the employment model during 1994–2008.

2.1 Growth model and macroeconomic policy

After a long period of economic crisis in the 1980s and early 1990s, in 1994 the Greek economy entered a period of sustained growth which ended with the global financial crisis in 2008. During 1994–2007 GDP grew annually by 3.7 per cent on average: indeed, from 2001 to 2007, the Greek economy was the fastest growing economy in the Eurozone, after Ireland. High rates of investment and productivity growth prevailed over the whole period but job creation was insufficient to absorb both new labour force entrants and heavy immigration inflows during 1994–1999. The unemployment rate thus increased by 3.3 percentage points between 1993 and 1999 and declined only in the following decade (from 12.1 per cent in 1999 to 7.7 per cent in 2008).

Rising domestic demand and profitability were the main drivers of private capital accumulation and GDP growth. The main determinant of increase in domestic demand was consumption, fuelled by rising real wages, rents and profits, and sustained public spending, tax cuts and tax evasion, and growing private borrowing. A second determinant was public investment in infrastructure – which accelerated in the years before the 2004 Athens Olympics – and private residential investment. As for profitability, the other driver of private capital accumulation, this followed a steady upward trend over the whole period. In 2007, the profit rate was only 7 per cent below its average in the ‘golden’ post-war period of Greek capitalism (1961–1973).

During 1994–1999, macroeconomic policy was geared towards preparing Greece for joining the EMU. It consisted in restrictive fiscal and exchange rate policies and interest rate reductions. Restrictive fiscal policy and the continuation of the policy of overvaluation of the drachma, initiated in 1987, contributed to a marked decrease in inflation, the public deficit and the debt-to-GDP ratio, but also to a major deterioration in competitiveness; while the fall in interest rates operated as a stimulus to productive investments. Greece joined the EMU on 1 January 2001 and benefited from the euro’s low interest rates. Real interest rates were even lower since Greece maintained a permanent inflation differential with the Euro area.

Fiscal policy became strongly expansionary in the first half of the 2000s, breaching the 3 per cent limit for public deficits in EMU. The public deficit escalated from 3.1 per cent to 7.5 per cent of GDP between 1999 and 2004. Although some effort towards fiscal adjustment was made in 2005, the public deficit rose again, to 6.4 per cent of GDP in 2007. The gross public debt-to-GDP ratio also followed an upward trend; it passed from 96.3 per cent in 1994 to 98.9 per cent in 2004 and 105.4 per cent in 2007. Falling interest rates from 1994 to 2000 and very low real interest rates from 2001 onwards provided a strong incentive for both public and private borrowing. Savings dropped from 20.4 per cent of GDP in 1994 to 7.1 per cent of GDP in 2008, while Greek household debt reached 45.3 per cent of GDP in 2007 (Bank of Greece 2008). Expansionary fiscal policy and low interest rates fuelled domestic consumption and investment and kept inflation constantly above the Eurozone average by 1–1.5 percentage points, thus undermining competi-

tiveness, while the huge drop in savings below investment increased external debt and current account deficits (Economou 2010).

2.2 Production system and regime

In the end of the 1980s Greece was the most agrarian and second least tertiarised economy in the EEC, after Portugal; the share of public sector enterprises in GDP was the third highest in Western Europe after those of Portugal and Italy; product market regulation was among the strongest in the OECD; and micro and family enterprises thrived in both the agricultural and non-agricultural sectors.

In the 1990s and 2000s, the importance of agriculture and manufacturing in GDP continued to decline, as in the 1980s, while production and growth dynamics moved decisively towards tourism, construction, services and shipping. At the same time, major transformations took place in the production regime, namely the privatisation of state-controlled banks and public companies, contracting-out of public activities to private firms, market deregulation in banking and public utilities and capital concentration in private services. Although important by Greek standards, the privatisation and market deregulation processes were slow in international comparison and partial in many cases because of strong resistance by unions and public opinion, especially to the privatisation of public utilities. European capital was a major actor in these developments. European industrial firms and multinationals bought out industrial firms, carried out the most important public works in consortiums with Greek firms, took over big public procurement contracts, participated in privatisations of public companies and invested in retail, banking and insurance, telecoms and hotels to take advantage of the rapidly growing demand for services.

The aforementioned changes in the production system and regime further increased the feminisation of employment and were accompanied by extensive use of migrant labour to cover labour shortages and reduce labour costs in many sectors. Migrants today constitute the majority of manual workers in Greece.

2.3 Welfare state and regime

The main characteristics of the Greek welfare state and regime at the end of the 1980s were (Karamessini 2010):

- an extremely fragmented pay-as-you-go pension system with major inequalities in entitlements, a diminishing ratio of insured persons to pensioners and extensive and long-standing contribution evasion;
- major disparities in levels of cover and access to health care between different population groups and a high level of private health expenditure despite the newly established National Health System (NHS);
- strong familialism and gender bias, reflected in the residual character of both unemployment compensation, social assistance and social care systems, as well as in the lower legal age of retirement for women and special early retirement schemes for married women and mothers of children under 18. Strong familialism and the gender bias of the welfare regime kept the female activity rate low.

Reforms of the pension system in the 1990s and 2000s established mixed funding of insurance funds through contributions and general taxation. They also introduced a means-tested supplement to low basic pensions, increased the minimum insured time for full pension entitlement and reduced the replacement rate of pensions. Furthermore, they gradually equalised the legal age of retirement between public and private sector employees, tightened the eligibility criteria for early retirement of women with minor or disabled children and equalised women's legal age of retirement with men's at 65 for those insured from 1 January 1993 onwards. However, the reforms did not ensure the financial sustainability of the pension system, which has been eroded primarily by extensive contribution evasion by employers and the expansion of informal work. Similarly, reforms of the public health service have not prevented the spectacular rise in private health expenditure, which reached 57 per cent of total health expenditure in 2005, the highest share among OECD countries.

The late 1990s and 2000s also saw an improvement in maternal and parental leave and the proliferation of child and elderly care services. However, this active reconciliation policy came fairly late relative to the growing demand for care by dual-earner households. The gap was covered by large numbers of migrant women hired by high- or medium-income households as carers for children and the elderly. Just before the current crisis, Greece had the lowest coverage of children and elderly by care services in the former EU15. Such low coverage, along with very high youth unemployment rates since the early 1990s, were the main determinants of the significant fall in the fertility rate and entrapment in low-fertility equilibrium.

2.4 Industrial relations and wage determination

From the mid-1970s through the 1980s industrial relations were extremely conflictual, while state intervention in wage determination was very strong. The 1990s and 2000s saw a weakening in such intervention and a decrease in capital–labour conflict. In 1990, the system of automatic indexation of wages to inflation was abolished, while a new law on ‘free collective bargaining’ changed its structure and replaced state-controlled compulsory arbitration, in place since 1955, by independent third-party mediation and arbitration. As a result, the share of arbitration awards in the total number of collective agreements sharply declined. Strike activity also declined in the 1990s. The recession of 1990–93, the ideological impact of the collapse of the communist bloc on the union factions of the Left and the accession to power of a liberal government that remained in office during 1990–93 contributed to a turn by the majority of trade unionists towards a social-partnership approach to industrial relations, away from the adversarial approach of the previous period (Karamessini 2009). EU integration is an additional determinant of the gradual decline in industrial relations conflict. Its influence has been exerted through the establishment of social dialogue institutions and the achievement of social consensus on the country’s entry in the EMU, which persuaded trade unions to moderate wage claims (Kouzis 2002).

National-level bargaining on the national minimum wage and sectoral or occupational minima is the core feature of the Greek collective bargaining system. Company-level agreements are relatively few in number. Outside the public sector, the basic pillar of the Greek union

movement in the 1990s and 2000s was public utilities and banking, which also dominated the leadership of the National Confederation of Greek Labour (GSEE) throughout this period. Because of high union density, employment protection and their capacity to mobilise their members, public utility and banking unions were equally the basic pillar of general strikes which reinforced GSEE's bargaining power during negotiations on the National General Collective Agreement. The role of the latter is crucial in the collective bargaining system, since it not only determines the level of the national minimum wage but also sets the floor for employment and working conditions and workers' rights (working time, leave, rights of part-timers, apprentices, student workers, equal treatment, funding of training, severance pay and so on). Since the 1980s, in bargaining with employers' organisations, the union federations of private sector employees have used national minimum wage increases as the floor and the best rate achieved by public utilities and banking federations as the target. In the late 1990s, the bargaining rounds between management and the strong unions in public utilities and banking were decoupled from those between GSEE and peak employers' organisations on the national minimum wage. A basic mechanism of articulated bargaining and wage drift was thus broken (Ioannou 2000).

Real compensation per employee declined substantially during 1990–1993 (3.2 per cent per year on average) and then increased slightly below productivity between 1994 and 2000. Although the position of employers' organisations in wage bargaining became harder in the EMU context (Ioannou 2010), real wages increased slightly above productivity between 2001 and 2007.

2.5 Employment regime

Strong protection against the dismissal of formally employed permanent employees, especially white-collar workers, has been a core element of the traditional Greek employment regime, along with extensive informal/irregular work. The former has remained intact for the past twenty years, the only exception being a 2005 law that abolished for persons newly hired in public utilities the stronger protection against dismissal of employees in these firms than in private firms. As for informal work, this expanded in the 1990s and 2000s, mainly due to

mass illegal immigration and the irregular situation of large numbers of migrants staying and working in Greece. However, efforts have also been made to introduce types of formal employment and working time flexibility in the labour market in the past twenty years. Union opposition tempered the level of flexibility introduced by governments, however, and ensured relatively good protection for employees involved in some forms of atypical work, such as part-timers and temporary agency workers. In 2007, Greece had the lowest rate of part-time employment and incidence of flexible working-time arrangements in the former EU15, while the rate of fixed-term contracts among employees was below the EU27 average. At the same time, project/service contracts among dependent workers, uninsured employment and informal/irregular work thrived but, by its very nature, remained unrecorded.

3. From success to collapse

The socio-economic model just described achieved very high GDP and productivity growth over the whole period of 1994–2008, leading to real economic convergence with more developed EU economies. Other successes of the model were: real wage growth in line with productivity, which allowed workers to reap the fruits of growth; great stability of employment for permanent employees; and a continuous rise in the female employment rate. But the model also suffered from shortcomings, such as low job growth, high youth and female unemployment rates, pronounced labour market segmentation, precariousness in the legal status and living conditions of migrants, high income inequalities and poverty rates – primarily due to the inadequately redistributive character of the tax and benefit system – and a rapidly rising current account deficit. However, it is the high indebtedness of the state that proved to be the model's Achilles heel.

3.1 Growing current account deficit

The current account deficit climbed from 3.2 per cent of GDP in 1998 to 16.3 per cent in 2008, while the deficit of the balance of goods and services rose from around 10 per cent in 1998 to 12.7 per cent of GDP in 2008. The balance of goods and services was responsible for only 31 per cent of current account deficit deterioration between 1998 and 2008,

however, the remainder accounted for by the incomes balance – a major increase in interest payments for external debt – and the decrease in net current transfers (Manassaki *et al.* 2010).¹ Regardless of each component's contribution to the deterioration of the current account deficit, it is evident that the huge deficit of the balance of goods and services is no longer sustainable from a longer term growth perspective. The question is what its determinants are. Debate on this topic is highly controversial.

Throughout the 2000s, the Bank of Greece has attributed growing deficits in the balance of goods and services mainly to losses in price competitiveness due to the persistent inflation differential with the Eurozone average. Indeed, between 2000 and 2008, Greece's real effective exchange rate based on consumer prices appreciated by 8.1 per cent in respect of the other Eurozone partners and by 17 per cent in respect of all trading partners. But as early as 2003, the Annual Report of the Governor of the Bank of Greece suggested that real wages should increase less than productivity, while nominal wages should increase in line with productivity and average inflation in the Eurozone until the inflation differential was erased. Asking wage earners to bear the full adjustment cost followed the mainstream approach of EU institutions. Wage-driven inflation was later on contradicted by EU publications attributing 67 per cent of the rises in Greek prices during the first half of the 2000s to profit margin increases, 20 per cent to indirect tax increases and 13 per cent to labour-cost increases (ECB 2006; European Commission 2007). Given that real wages grew in line with productivity during that period, the finding that inflation was mainly profit- and tax-driven was very important with regard to assigning responsibilities to the actors involved in determining the outcome. Alternatively, the Annual Reports and several studies by the Institute of Labour of Greek Trade Unions (see, for instance, Institute of Labour GSEE/ADEDY 2010; Ioakimoglou 2011) have repeatedly underlined the minimal role played by labour costs in the loss of competitiveness in the 2000s; highlighted the important role played by euro appreciation² – 36 per cent between 2001 and 2008 – and low non-price and structural

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1. Transfers to Greece include emigrants' remittances and EU transfers within the framework of the Common Agricultural Policy, while transfers from Greece include immigrants' remittances and the country's contributions to the EU budget.
 2. Greece's extra-Eurozone trade represented about 40 per cent of exports and 45 per cent of imports in 2007.

competitiveness; and showed that Greek employers could easily have increased price competitiveness by reducing their profit margins, given that these were the second highest in the EU15 after those in Ireland during 1995–2009. These reports and studies, finally, attributed a significant part of deficit deterioration not to loss of competitiveness but to the much higher growth in Greece relative to its trading partners.

Empirical evidence corroborates the minimal role of labour costs in explaining the deterioration in the balance of goods and services between 1998 and 2008. However, analyses of all the aforementioned institutions have missed the important fact that 38 per cent of the deterioration was due to the fuel-related deficit, caused by the significant rise in petrol prices and Greece's great energy dependency on petrol.

3.2 High sovereign debt

As previously mentioned, the gross public debt-to-GDP ratio rose from 96.3 per cent in 1994 to 105.4 per cent in 2007, despite falling interest rates in the process of joining EMU, low interest rates after adopting the euro in 2001 and high GDP growth throughout the period 1994–2007. High GDP growth and profit rates induced European banks to lend abundantly to Greek firms, banks and the state (Milios and Sotiropoulos 2010). In a situation of oversupply of funds and low interest rates, the Greek sovereign debt not only seemed but was indeed refundable and repayable.

High public indebtedness at the onset of the global financial crisis reflected the cumulative effect of a long-standing public revenue deficit (Stathakis 2010). In 2007, public revenues were equal to 37.3 per cent of GDP (against 44.4 per cent for the EU27), while public expenditure was 44.7 per cent of GDP (against 45.7 per cent for the EU27). This deficit stemmed from structural tax avoidance and evasion by firms and the self-employed; tax privileges of banks, maritime capital, the Church of Greece, liberal professions and so on; as well as tax concessions for capital and high incomes since 2000. As a result, public revenues decreased from 43 per cent of GDP in 2000 to 37.3 per cent in 2007. With regard to tax evasion, it is indicative that 64 per cent of all Greek taxpayers declared income below the tax-free income ceiling and 17 per cent zero income for 2008, while wage earners and retirees paid 63 per

cent of all income tax for the same year (Vasardani 2011). On the expenditure side, the sovereign debt reflected the cumulative effect of excessive military expenditure; the cost of rescuing indebted private firms in the 1980s and recently banks; extensive corruption of public officials leading to overpricing of public works and public procurement; the deficit of the 2004 Athens Olympics; and growing social security deficits financed by the state budget: 6.6 per cent of GDP in 2009. Estimates of military expenditure indicate that Greece annually spent 5.8 per cent of GDP on armaments in the 1970s, 6.2 per cent in the 1980s, 4.6 per cent in the 1990s and 3.1 per cent during 2000–2008 (Grebe and Sommer 2010). As for corruption, this should be regarded as an essential component of the economic model rather than an obstacle to a liberal economy (Tsakalotos 2010), encouraged by contracting-out of public works and activities and big public procurement projects.

3.3 Collapse and conditional 'rescue'

The global financial crisis turned a high but manageable debt into an uncontrollable and unsustainable one. As a result of a strongly counter-cyclical fiscal policy implemented in 2008 and 2009, the public deficit passed from 6.4 per cent to 15.4 per cent of GDP and the gross sovereign debt from 105.4 per cent to 127.1 per cent of GDP between 2007 and 2009. Public expenditure increases accounted for 70 per cent and tax shortfalls for 30 per cent of the deterioration of the deficit in 2008 and 2009. Financial market speculation on Greece's sovereign bonds started in mid-November 2009, in an international context of rising sovereign debts and short supply of global financial capital, looking for the most secure financial investments internationally. Questioning the solvency of the Greek state and betting that the EU would not bail out Greece, financial market investors pushed upwards spreads on Greek sovereign bonds and the price of credit default swaps.

In response to its EU commitments (European Council, Euro Group and ECOFIN decisions) and to soothe the financial markets, between December 2009 and March 2010 the Greek government announced four packages of measures meant to reduce the public deficit. Despite the adoption of these packages, speculation in financial markets soared and Greek sovereign bond spreads skyrocketed. As a result, the Greek government requested financial assistance from the Euro area. Greece's

default would not only entail the collapse of its big lenders – mainly French and German banks – but also sweep away EMU. In 2 May 2010, the Greek government, the European Commission, the European Central Bank (ECB) and the IMF agreed on an economic adjustment programme (EAP) in exchange for financial aid provided by Eurozone countries and the IMF (European Commission 2010). Support is granted by instalments whose disbursement is conditional on the strict implementation of a Memorandum of Understanding (MoU), describing in detail the measures to be taken by the Greek government and revised periodically.

One year after the implementation of the EAP and despite a considerable reduction of the public deficit in 2010, recession led to important deviations from fiscal adjustment targets for 2011, a spectacular increase in the sovereign debt-to-GDP ratio and Greece becoming unable to service its debt. At the same time, financial market speculators were attacking Italy's and Spain's sovereign bonds. In 21 July 2011, Euro area country leaders decided a second financial aid package for Greece with lower interest rates and extended maturities for new loans to be disbursed by the European Financial Stability Facility (EFSF). For the first time, private lenders were urged to participate voluntarily in the whole package of debt refinancing/restructuring. In exchange for this second financial bailout, the Greek parliament adopted, by a slim majority, a Medium-Term Fiscal Strategy 2012–15 (MTFS), prolonging and reinforcing the austerity measures and structural reforms of the EAP and adding a huge privatisation programme of public firms, agencies and assets.

The structural determinants of Greece's high sovereign debt are of course internal; but Greece is also paying for a global crisis it did not provoke and the deficiencies of EU integration for which it was not the only and certainly not the main responsible party. In other words, without the global financial crisis, the Greek sovereign debt crisis would not have erupted, while its skyrocketing through speculation would have been stemmed in a more solidaristic and federal-type currency union. Moreover, in such a union, the restructuring and refinancing of Greece's sovereign debt would not endanger its foundations.

4. Supervised economic adjustment and acceleration of the neoliberal project

Apart from saving the euro and EMU, the voluminous financial aid provided to Greece by the Eurozone countries and the IMF, EAP and the recently adopted MTFs serve the interests of Greece's creditors as well as those of the hegemonic fractions of Greek capital. They are intended to prevent losses by the European and American banks holding Greek sovereign bonds and to satisfy long-standing demands made by the Confederation of Greek Enterprises, which welcomed EAP as an opportunity to curb social resistance to 'necessary reforms'. EAP is a neoliberal project in which 'adjustment' is sought through a massive assault on workers' income and rights, public ownership and the welfare state. In this way, it accelerates and completes the transition of Greece's traditional model of state-led capitalism to a liberal model of capitalism under the auspices of its lenders. Financial aid conditionality and its supervision by the troika (ECB, European Commission and IMF) have entailed a substantial loss in national sovereignty with regard to economic and social policymaking, as well as a host of infringements of the Greek Constitution.

4.1 Neoliberal offensive, 'shock therapy' and the punitive character of financial aid

EAP endorses the 'Washington consensus' which epitomises the neoliberal project worldwide and inspired the IMF Structural Adjustment Programmes in Third World countries. The EAP has three basic objectives: fiscal consolidation to create primary surpluses in the general government balance and curb increases in sovereign debt; stability of the banking system through liquidity guarantees, given the high exposure of Greek banks to Greek sovereign bonds; and 'internal devaluation' to improve competitiveness and reduce external deficits. The term 'internal devaluation' is synonymous of reductions in labour costs, given that national currency devaluation is impossible. Finally, by reducing consumption and encouraging private investment through austerity measures, internal devaluation, public sector downsizing and privatisation, the EAP is intended to push the Greek economy towards a private-investment and export-led growth pattern. However, no reference is made in the EAP to technological progress, innovation and structural competitiveness.

Table 1 General government balance (% of GDP)

	EAP target	Achieved
2009 base year	-13.6	-15.4
2010	-8.0	-10.5
2011	-7.6	-9.0*
2012	-6.5	
2013	-4.8	
2014 end year	-2.6	

* Estimate (State Budget 2012).

Besides its neoliberal character, a crucial trait of EAP is its ‘shock therapy’ approach to fiscal adjustment.

A huge and frontloaded fiscal consolidation effort is to be carried out through austerity and structural measures. The target for general government deficit reduction between 2009 and 2014 is 11 percentage points of GDP; a reduction of 5.6 percentage points was scheduled for the first year (Table 1). Taking into account expected falls in GDP, the estimated size of cumulative fiscal consolidation measures over 2010–2014 amounts to 21.4 per cent of GDP in 2009 (European Economy 2011, Table C1, p. 78).

‘Shock therapy’ was meant to produce primary fiscal surpluses in two years, so that Greece would start repaying its creditors without external financial aid, notwithstanding the expected recessionary impact of the huge fiscal consolidation effort and the ensuing sizable increase in the sovereign debt-to-GDP ratio. The option of quick fiscal adjustment in spite of a strong recessionary shock – and certainly not through growth – as well as the initially high interest rate incurred for Eurozone country loans (5.2 per cent) reflect the punitive character of the financial aid by Eurozone partners and the stick used by them to ensure the Greek government’s compliance with the conditions set in the EAP’s Memorandum of Understanding.

Hereafter we discuss the EAP and MTF5 measures concerned with fiscal consolidation and internal devaluation. These two objectives are interrelated since fiscal consolidation generates recession and unemploy-

ment, thus contributing to the moderation of wage claims, work intensification and reduction in labour costs.

4.2 Fiscal consolidation, public sector downsizing and welfare state retrenchment

According to EAP, fiscal consolidation will be attained through restrictive fiscal policy and structural reforms. Planned public expenditure cuts are expected to contribute 64 per cent of the achievement of the programme's target for the deficit, the remaining 36 per cent being taken care of by planned public revenue increases. EAP serves a broader goal, namely the reduction of the size and role of the public sector in economic activity and welfare provision.

Austerity measures to reduce public spending

Austerity measures implemented since the beginning of 2010 include big cuts in the following: salaries, bonuses and overtime payments in the public sector; public and private sector pensions; operating expenditures of line ministries; state budget allocations to municipalities and social security agencies; and public investment.

EAP and MTFS explicitly aim to bring the public sector wage bill down from 13 per cent of GDP in 2009 to 8.1 per cent of GDP in 2015 and to reduce the 11 per cent wage premium of the public sector over the private sector, after controlling for employees' and jobs' characteristics. Between May 2010 and May 2011, nominal wages in the civil service decreased by 15 per cent and those in public utilities, agencies and undertakings by 25 per cent, while nominal pensions in the public and private sectors fell by 10 per cent. The respective declines in real wages were 20.4 per cent and 30.4 per cent, while real pensions fell 15.4 per cent. New cuts were recently announced for supplementary and lump-sum pensions. Additionally, a new single pay scale in public administration took effect on 1 November 2011, bringing about a new reduction in civil servants' nominal wages by 30 per cent on average. Wages in public utilities and undertakings were subject to cuts of a similar magnitude that took effect on the same date.

Reduction of the public sector wage bill also requires retrenchment of public employment and working time changes. EAP and MTSF include a series of measures in this direction:

- Increase in the standard working time from 37.5 to 40 hours a week without a pay rise and drastic reductions in overtime working.
- Suspension of recruitment of permanent employees in the public sector in 2010, except in education, health care and security; application of the rule 'one hire for 10 exits' in 2011 and that of 'one hire for five exits' during 2012–2015.
- Reduction of employees on short-term contracts by 30 per cent in 2010, 50 per cent in 2011 and 10 per cent annually during 2012–2015.
- Mergers of municipalities and reduction of their number by two-thirds and of local government personnel by 50 per cent.
- Restructuring and downsizing of public companies, for example, railways and bus services.
- Closure or merger of government entities and establishment of a labour reserve for all or part of their staff that will be paid at 60 per cent of the base wage for one year, before being dismissed.
- Superfluous personnel of all government entities and state-owned enterprises will be also transferred to the labour reserve or dismissed.

In 2010, public sector employment decreased by 10 per cent overall, which is the outcome of both the reduction of employees on short-term contracts and non-replacement of exits for retirement. The MTSF plans a further 20 per cent reduction in public sector employment between 2011 and 2015.

Welfare state retrenchment to reduce social spending

EAP and MTSF aim to reduce expenditure on social transfers from 20.8 per cent of GDP in 2009 to 17.3 per cent in 2015. In 2010, social

spending fell by 9.6 per cent due to pension reform and welfare state retrenchment. In line with EAP, a radical pension reform was adopted in summer 2010. This introduced a two-pillar pension system (basic means-tested and contributory pension) to replace the former one-pillar pay-as-you-go system subsidised by the state. The state is now financially responsible only for the basic pension. The reform raised the qualifying period for full pensions to 40 years by 2015 and indexed this period to life expectancy hereafter. A new way of calculating the pension level was introduced, along with big penalties for early retirement (6 per cent reduction per year) in order to substantially reduce wage replacement rates. This same pension reform merged all social security funds into three and brought the pension system of civil servants into line with the private sector pension system by eliminating all its more favourable provisions.

A series of other reforms are also aimed at making savings in welfare state expenditure: increased admission fees and co-payments for outpatient and diagnostic services in public hospitals; tightening of criteria for seasonal unemployment benefits; mergers of schools and reduction of their number by 14 per cent; mergers of hospitals and clinics; cuts in municipal budgets for schools, crèches and nurseries, as well as in university budgets. Increases in school class size, reduction in the number of employees on short-term contracts, non-replacement of those who retire and reductions in overtime payments (especially for medical and nursing personnel in hospitals) are deteriorating the quality of education, health and social care services, thus putting pressure on the family as welfare provider. Positive developments concern the rationalisation of health care expenditure through lower negotiated prices for medicines paid by social security funds and the implementation of an e-prescription system and a central e-procurement system for hospitals.

Increasing public revenues from taxes and privatisation

The main public revenue-increasing measures since the beginning of 2010 include increases in VAT rates by 20 per cent and in excise taxes on fuel, cigarettes and alcohol by 33 per cent; new indirect taxes; extension of VAT obligation to previously exempted economic activities; application of a progressive taxation scale on inheritances and bequests; imposition of 'crisis levies' on profitable firms, high value real estate and households with high incomes; increase in taxation on

Church real estate and introduction of a tax on Church property income; tax settlement for all uncontrolled, outstanding or litigious cases of firms and the self-employed with tax authorities; and revaluation of fines on unauthorised buildings and settlement of urban planning infringements. Although some of the above measures increase the fairness of the tax system, the inability to curb tax evasion and the rise in the indirect-to-direct tax ratio (from 1.37 in 2009 to 1.63 in 2010) point to an overall regressive impact of EAP's tax measures on income.

Public revenue increases are also expected from privatizations. The MTFS comprises a huge privatisation programme of public firms, agencies and assets (banks, transport companies, ports, airports, utilities, energy, telecoms, gaming industry and state-owned real estate). Envisaged privatisation revenues are up to 50 billion euros, equivalent to 6 per cent of annual GDP over two years (cumulative) and more than 20 per cent over the next five years and are intended to reduce sovereign debt (IMF 2011).

4.3 Dismantling the employment model and undermining trade unions and collective bargaining

EAP and MTFS include a large number of labour market and product market reforms dismantling the Greek employment model and undermining trade unions and collective bargaining. These reforms serve several goals at a time: the reduction of the wage bill in the public sector and radical downsizing of the latter; the opening up of opportunities for capital concentration in services through a substantial decrease in self-employment; and internal devaluation, that is, drastic reductions in nominal wages in the private sector.

Drastic reduction in public sector employment and self-employment

Retrenchment in public sector employment is the outcome of a combination of direct measures (parsimonious hiring, labour reserve, dismissals) and indirect ones (closure, restructuring and privatisation of public entities and companies). As for self-employment, a number of converging factors are curtailing it. First, recession is putting great pressure on own-account workers and micro-entrepreneurs, leading to mass closures of micro-businesses. Second, the government has

removed restrictions on competition, business and trade in more than one hundred regulated professions. This has intensified competition and reduced minimum compensation/returns in times of drastically falling demand, pushing great numbers of the self-employed out of business and inducing a concentration of capital in the corresponding activities.

Massive attack on employees' rights

The following measures have been adopted: halving of notice period and level of severance pay for individual dismissals; increase in the minimum threshold for collective dismissals; labour reserve for redundant personnel in the public sector; extension of probation period for new hires from three months to one year; extension of the cumulative maximum duration of fixed-term contracts to three years and easing of conditions for derogations; extension of maximum duration of spells of employment for temporary agency workers from 18 to 36 months; extension of maximum duration of rotating work at a given firm in case of financial difficulties from six to nine months per year; permission for part-time work in public utilities; abolition of the 10 per cent wage premium for short part-time working; reduction of overtime pay by 20 per cent; increase in weekly working time in public administration from 37.5 to 40 hours; easing of flexible working time arrangements.

The most important of the above measures are those making individual and collective dismissals easier in the private sector, as well as those concerning the labour reserve and dismissals in the public sector. They constitute the dismantling of a core feature of the Greek employment model, namely strong employment protection of permanent employees.

Defeating the unions, undoing collective bargaining, expanding individual bargaining

EAP and MTFs have led to the following changes in the wage-setting system aimed at defeating the unions, undoing collective bargaining and expanding individual bargaining in the private sector:

- (i) The scope of collective bargaining on the national minimum wage has been reduced through the introduction of sub-minimum wages for apprentices aged 15–18 and first labour market entrants below 25 years of age at 70 per cent and 84 per cent of the national minimum wage, respectively.

- (ii) The scope of mediation and arbitration has been reduced to basic wages only, thus weakening the unions' power against intransigent employers' associations in negotiations on other provisions.
- (iii) Collective bargaining on wages was suspended in all public utilities, agencies and undertakings where cuts in nominal wages in 2010 and 2011 were introduced by law. A recent law, in force since 1 November 2011, brought about even more significant cuts by imposing wage ceilings on administrative personnel – in accordance with the new pay scale for civil servants – and defined a maximum per capita monthly wage bill at €1,900. It goes without saying that collective bargaining is now practically dead in this fundamental pillar of the pre-crisis wage-setting system where union power has been concentrated for decades.
- (iv) Suspension for 2012–13 of extension of the coverage of sectoral and occupational collective agreements to non-union members by the Minister of Labour. This induces firms to quit employers' organisations, thus indirectly undermining collective bargaining at the sectoral or occupational level and promoting individual bargaining between employers and employees on wages.
- (v) In case of overlapping issues and clauses, company-level collective agreements have precedence over sectoral and occupational agreements, even if their provisions are less favourable for the employee. Company-level agreements can now be signed not only by unions but also by associations representing at least three-fifths of a firm's staff, who can easily be subjected to employer manipulation in small firms.

On top of these changes, the Greek government is now negotiating with the German government for the creation of four pilot Special Economic Zones in which taxation and labour law will be less restrictive for investors than in the rest of the national territory. In these zones wages would be lower than nationally agreed sectoral and occupational minima and might also fall below the national minimum wage.

Apart from institutional changes, the big rise in dismissals and unemployment undermines union power even more. Almost all collective agreements concluded in 2010–11 provide for wage freezes. In

summer 2010, GSEE concluded a collective bargaining agreement with a three-year horizon which foresees a freeze of the national minimum wage for 2010 and an average annual increase below 1 per cent per year over 2010–12. Although inflation was 4.7 per cent in 2010 and is expected to be 3 per cent in 2011, the troika is asking the Greek government to persuade the social partners to renegotiate downward minimum wage increases for 2011–12 or to impose a reduction of the national minimum wage by law.

5. Killing the ‘patient’: the dramatic consequences and impasse of austerity policy

To date, the neoliberal offensive has had a major disruptive effect on social cohesion, as well as on people’s lives and morale, especially the most vulnerable, while it is leading the economy to collapse and the state to default under much worse conditions than before the ‘financial rescue’ by the lenders. Eighteen months of supervised economic adjustment has led to huge wage and pension cuts, excessive taxation of low and medium incomes and a retrenchment of the welfare state. Unemployment has climbed from 9.5 per cent in 2009 to 16.3 per cent in the second quarter of 2011 and is still on the rise. Youth unemployment has reached 43 per cent, while are families experiencing major income losses and are increasingly unable to provide for their offspring. At the same time, social protection is being weakened and the quality of social goods and services eroded. Increasing numbers of people are being pushed into absolute poverty and social exclusion.

From an economic and financial perspective, ‘shock therapy’ is killing the patient, having produced a debt trap and a spiral of austerity-recession-austerity. Total fiscal effort in 2010 amounted to 9.7 per cent of GDP.³ An equally significant effort is required by Greece’s lenders for 2011.⁴ Deepened and permanently fuelled by fiscal consolidation measures, the recession is destroying thousands of jobs, own-account

3. This is derived by adding the 4.5 per cent decrease in GDP to the 5.2 percentage-point reduction in the public deficit.

4. The deficit reduction target for 2011 is 2.8 percentage points of GDP, but GDP is projected to decline by 6.5 per cent.

workers and small and medium-sized businesses and seriously eroding the tax base and social security finances. Recession is thus undermining the accomplishment of fiscal targets for 2011 and further aggravating an already unsustainable debt-to-GDP ratio. In the first and second quarters of 2011, GDP recorded a fall of 5.5 per cent and 7.3 per cent, respectively, on an annual basis, while net public revenues in January–June 2011 declined by 8.3 per cent compared to the same period in 2010. Furthermore, the IMF recently revised upwards forecasts for the sovereign debt ratio at 166 per cent in 2011 and 189 per cent in 2012 and unemployment at 18.5 per cent in 2012.

Table 2 Main economic indicators, Greece, 2009–second quarter 2011

	2009	2010	2011q ¹	2011q ²
	annual rates %		Change (%) compared to previous year or rates (%)	
GDP	-2.0	-4.5	-5.5	-7.3
Investment (GFCF)	-11.2	-16.5	-20.8	-17.9
Employment	-0.7	-2.7	-5.2	-6.1
Unemployment rate (% labour force)	9.5	12.5	15.9	16.3
Inflation	1.3	4.7	4.5	3.3
Real wages	3.3	-9.3		
Unit labour cost	5.4	-3.0		
Sovereign debt ratio (% GDP)	127.1	142.8	166*	
Industrial production	-9.4	-5.8	-6.0	-11.7
Retail – turnover	-9.3	-6.9	-14.0	9.1
Construction	-17.5	-31.6	-32.7	-39.9
Exports of goods	-22.7	11.5	21.4	21.5
Imports of goods	-27.8	-1.6	1.3	4.1
Travel receipts (tourism)	-10.6	-7.6	4.7	10.4
Receipts from sea transports	-29.4	13.8	-9.1	-12.7
Current account balance	-14.0	11.8		

Note: * Annual estimate for 2011 by the IMF.

Source: Hellenic Statistical Authority. Bank of Greece, for wages and labour cost.

We have already mentioned that, as a result of the above situation, the Greek parliament last July adopted the MTF5 2012–15, prolonging and reinforcing the austerity measures and structural reforms of the EAP

and fulfilling the conditions set by the troika for a 'second financial bailout package' by Eurozone member states and the IMF, finally adopted by the European Council on 21 July. Later on, the troika dictated a number of additional measures to those in the EAP and the MTFS, so that the public deficit target for 2011 could be reached.

The revenue-enhancing measures of the whole package consist of new taxes and taxation changes – which excessively increase the tax burden on low and medium incomes and property – and the huge privatisation programme previously mentioned. Tax measures include: the reduction of the tax-free income ceiling from 12,000 euros to 5,000 euros; the imposition of a solidarity contribution on individual incomes at 1–5 per cent, depending on income level, and a lump-sum levy on all self-employed of 300 euros and 500 euros for financial years 2011 and 2012, respectively; an increase in the unemployment solidarity contribution for private sector employees by 1 per cent and for civil servants by 2–3 per cent, and a monthly fee for the self-employed; elimination of tax credits, deductions and invoice-based tax refunds; a 60 per cent increase in the basis for presumptive taxation; the reduction of the threshold for the individual property tax and an increase in the minimum tax rate; a sizeable one-off levy on all real estate; and new increases in excise duties and other indirect taxes. The expenditure-reducing measures of the package consist of further cuts in pensions exceeding 1,200 euros per month; the enactment of the new single pay scale and the labour reserve in the public sector; and the implementation of new cuts in the wage bill in public utilities and undertakings.

To conclude, by putting the economy in a debt trap and by creating a vicious circle of austerity, recession and renewed austerity, 'shock therapy' has led to a total impasse. Economic and social conditions have deteriorated, while the debt has become much less sustainable and manageable than at the beginning of the sovereign debt crisis. At the same time, given the dramatic fall of stock exchange prices, the stock exchange value of public companies is considerably below the market value of their assets, entailing a huge loss in real terms in the case of privatisation through the sale of state shares. The disastrous nature of this kind of policy is perceived as such by large parts of the Greek population and indignation is spreading, along with extreme insecurity, despair and lack of hope for the future. Since last June, social protest has not only reacted to particular measures but has focused on the overthrow

of the EAP, non-adoption of the MTFs and refusal to pay (part of) the debt and to sell public property. Voices from the streets and the squares are calling for the payment of the debt by those who created it, namely the political and economic elites of the country who are still enjoying their privileges and have massively transferred their deposits abroad, as well as by banks, speculators and 'rescuers' who are responsible for the uncontrollable escalation of the debt in the past two years.

6. What prospects – what alternatives?

Despite the failure of 'shock therapy' to promote fiscal adjustment beyond the first year of the EAP and the uncontrollable increase in the debt ratio, the leading powers in the Eurozone as well as the ECB and the IMF are unwilling to abandon the recipe. They have refused to negotiate a smoothing of the fiscal adjustment process by extending its duration and by leaving room and time for stimulating growth through public investment and for income redistribution through a radical tax reform and overhaul of the tax collection mechanism. Moreover, a recent idea for a 'Marshall Plan' for Greece was quickly abandoned, along with any approach to reducing the sovereign debt burden through growth. Such an adjustment would require more financial aid, increased EIB loans and fiscal transfers from the Structural Funds, as well as the reform of existing European institutions (for example, direct financing of Eurozone states by the ECB, its involvement in reducing the debt by buying sovereign bonds in secondary markets at market prices, Eurobonds and so on), paving the way for a federal type of European unification. All these alternatives have been the subject of a major European and international public debate, especially after the sovereign debt crisis also spread to Ireland and Portugal and it was realised that it was menacing EMU and the euro.

Although the decisions of the European Council at its last two meetings on the creation and role of EFSF and ESM are positive, given EU Treaty obstacles to changing the role and mandate of the ECB, there are still three thorny issues concerning the future of Greece and its people that remain unresolved. First, the debt ratio has risen to such heights that there is no viable alternative without a write-off of a substantial part of it. The need for a haircut on Greek sovereign debt was finally recognised by the European Council, at the meetings of 21 July and 26 October 2011. The last European Council put forward a voluntary bond exchange with a nominal discount of

50 per cent on notional Greek debt held by private investors. The objective of private sector involvement is to bring the Greek sovereign debt to GDP ratio down to 120 per cent by 2020. However, if achieved, this ratio will be only 7 percentage points lower than at the beginning of the debt crisis, while the debt will be still hardly sustainable in a weakened economy and impoverished society. Second, the haircut on the sovereign debt held by private investors is accompanied by a second EU–IMF financial package of up to 100 billion euros until 2014, including the required recapitalisation of Greek banks. Financial aid is conditional on the conclusion of a new multiannual programme that will repeat the failed economic policy recipe. The new programme will undoubtedly reinforce austerity and accelerate neoliberal reforms under reinforced supervision by the troika, with the establishment of a permanent monitoring capacity on the ground. Still, the prolongation of recession and sacrifices by the Greek people for the next three years (at least) will be fatal for the Greek economy and society and will also further undermine debt sustainability. Third, it is not foreseeable what the endogenous engines of growth would be after the neoliberal project is completed in a new European division of labour. We are however sure that the programmed privatisation of all public agencies and companies will permanently deprive the Greek state from strategic growth-enhancing tools. Growth will thus depend on the incentives provided to foreign multinational capital and the most internationalized fractions of Greek capital.

Alternatives to the failed and disastrous recipes implemented with regard to the Greek economy and people cannot be provided solely – or at all – at the national level. They are directly associated with debates on the future of EMU and the European integration project.

In a European perspective, Greece was the first Eurozone country to fall victim to the global rise in sovereign debt after the first phase of global financial crisis. It was also the first to switch to a full-fledged neoliberal economic adjustment process as a way out of the crisis. The new EU economic surveillance procedure and the Pact for the Euro are proposing the same way forward for all Eurozone countries, as well as for the six signatory countries of the Pact outside the Eurozone: that is, tightening fiscal policy and stimulating export-driven growth through competition on labour costs, taxes and welfare state retrenchment. However, coordinated restrictive fiscal policies are a self-defeating strategy for growth in the EU, while the increase in the interest rate on the euro and

the lack of exchange rate policy on the part of the ECB make the EU's economic prospects even gloomier. These developments render Italy and Spain even more vulnerable to the financial markets and make the exit of Greece, Portugal and Ireland from the crisis even more difficult.

Given the generalised trend towards socially regressive policies and the threat of EMU disintegration, it has become evident that there is a need for new hegemonic socio-political blocs at the national level, along with coordinated action at the European level, if alternatives to the current neoliberal project for Europe are to become credible. The Greek people would be the first but not the only beneficiary.

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Italy: Chronicle of a crisis foretold

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1. Introduction

Italy has not been hit directly by the financial crisis, but the ensuing global recession has taken a heavy toll on the real economy, much higher than in other European countries. The poor shape of the Italian economy at the outbreak of the crisis provides a good part of the explanation. This chapter sums up the main points of the analysis provided in Simonazzi *et al.* (2009) (Section 1) and considers the effects of the crisis on the major economic variables (Section 2). It argues that the crisis hit the Italian economy at a delicate time, in the midst of a process of restructuring. Given the high debt/GDP ratio, the drop in growth increased Italy's financial vulnerability. When the second round of the financial crisis hit the peripheral European countries of the Euro area, the Italian government, burdened with a huge public debt, was left helpless to resist speculative attacks and to avert contagion. The many weaknesses in the construction of the Economic and Monetary Union (EMU) and the dithering of European political leaders fuelled uncertainty, which wrecked the periphery and eventually engulfed Italy. Lacking any timely coordinated effort, austerity was the only option open to the periphery. By increasing taxes and cutting social spending and financial transfers to local authorities, and therefore services provision, fiscal austerity reached deep in the pockets of the usual 'ordinary people'. The chapter concludes with an assessment of an alternative – national and European – policy for growth.

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2. Before the crisis (and beyond)

Italy is characterised by multifarious dualisms: a dual production system, a dual labour market, familistic and unequal welfare and a north–south divide. On top of this, in the past two decades the Italian economy has recorded an extremely low rate of growth, which gave support to the hypothesis of a long-run economic decline.

Decline story. The decline story maintains that firms' size and industrial specialisation resulted in a lack of product and process innovation leading, in turn, to a loss of competitiveness, as evidenced – inter alia – by the decline in Italy's export share. This lack of innovation came together with the deregulation of the labour market and a long period of wage moderation, which made newly hired labour extremely cheap and disposable. This, according to the common view, explains growthless job creation and the very low productivity growth which, in turn, justifies – ex post – the low wage levels.

This interpretation, which enjoyed increasing popularity and became the consensus view,¹ had come up for reconsideration in the very years preceding the crisis. The recantation was led by the Bank of Italy, previously a champion of the decline story. Distinguishing between internal and cross-sectoral reallocation, Bugamelli *et al.* (2009a) found evidence of a reallocation of activity within rather than across sectors since the adoption of the euro: productivity growth has been relatively stronger in those sectors that once relied more on competitive devaluations to regain price competitiveness. Firm-level evidence from Italian manufacturing confirmed that low-tech businesses, which arguably benefited most from devaluations, had been restructuring more since the adoption of the euro. Restructuring entailed a shift of business focus from production to upstream and downstream activities, such as product design, advertising, marketing and distribution, and a corresponding reduction in the share of blue-collar workers. This evidence cut the nexus which had linked the data on 'frozen specialisation' with the hypothesis of a lack of innovation and restructuring.

1. See Ginzburg (2005), Coltorti (2007) and Simonazzi and Villa (2007) for an early contrary view.

Restructuring had been accompanied by outsourcing. Breda and Cappariello (2010) assess the extent of internationalisation of production of Italian and German firms between 1995 and 2006. The growth in offshoring had been substantial between 1995 and 2000 in both economies (it had been stronger in Germany, which had started from a lower level in manufacturing industry). After a phase of stagnation during the first years of the past decade, offshoring resumed its growth at a rapid pace in 2004–2006 and especially in Italy. This evidence seems to confirm that a change in strategies and a reorganisation of production was occurring among Italian firms. The new challenges posed by globalisation, the diffusion of information and communication technologies (ICT) and the adoption of the euro were inducing the most dynamic among Italian firms to rethink their organisation and their degree of vertical specialisation.

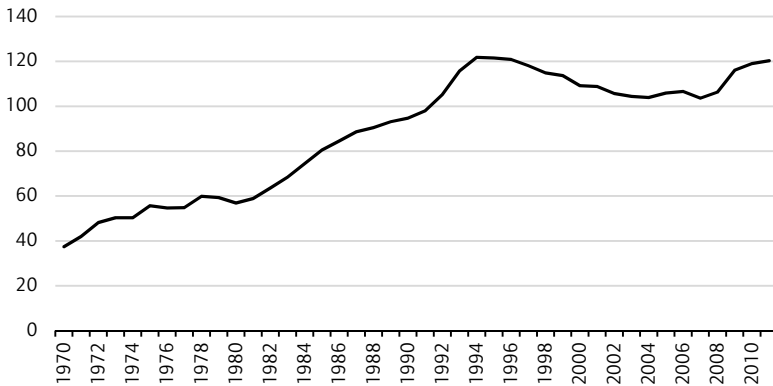
The ongoing process of restructuring was finally acknowledged by Rossi (2011) who, quoting the results of a huge study of Italian industry carried out by the Bank of Italy just before the financial crisis (Brandolini and Bugamelli 2009), noted that ‘[j]ust before the outbreak of the crisis we observed the start, although belated, of a process of restructuring in parts of the Italian productive system, with extensive adoption of new ICT, product and process innovation, internationalisation’. The process of change had been led by medium-sized firms, firmly rooted in district economies (Coltorti 2007). Thus we seem to have reached a new consensus: the crisis struck Italian medium-sized firms just as they were crossing the ford.

The dualistic labour market. Two decades of deregulation exacerbated the segmentation of the labour market. There has been an increase in employment (growthless job creation) but mostly based on atypical contracts. Young people entered the labour market on temporary contracts and with lower pay. Between 1992 and 2002, entry-level pay decreased by more than 11 per cent (from 1,200 euros per month to less than 1,100 euros) for young people aged 21–22 years of age (presumably with a “diploma”) and by 8 per cent for young people aged 25–26, possibly with a degree (from 1,300 to 1,200 euros per month). For both these groups the entry wage in 2002 had reverted to the level of 20 years previously (Rosolia and Torrini 2007). As argued in Simonazzi and Villa (2010) the difficulty finding a secure job at a decent pay led to an extremely high rate of young people co-habiting with their parents, delays in forming a family and an extremely low fertility rate. Due to the female younger cohorts’ greater labour market attachment and despite

the lack of policies to favour reconciliation, the female employment rate increased, although it remained firmly at the bottom among EU countries (46 per cent), followed only by Malta.

(Financing) the welfare state. The enactment of several reforms in the 1970s (employment and pension schemes, health and education) resulted in a rise in public spending (from 37 to 43 per cent of GDP, net of interest, between 1980 and 1985) without a corresponding increase in tax revenue. The financing of the ‘southern welfare model’, which was still far from ensuring universal coverage, was thus provided by borrowing. The middle classes (and the ‘third Italy’ in the north-east and elsewhere) managed to avoid paying taxes and turned their tax notices into bonds, underwriting the loans required to finance the deficit (Barba 2011) (Figure 1).

Figure 1 Debt/GDP ratio, Italy, 1970-2010



The policy of fixed exchange rates (EMS) in the 1980s, at a period of worldwide disinflation and high real interest rates, brought real interest rates to levels never seen before, further fuelling the debt. By 1992 the tax/GDP ratio had increased² (fluctuating between 45 and 47 per cent thereafter), but the 10 percentage point increase of the 1980s went to

2. At 34 per cent, the ratio of fiscal receipts to GDP at the beginning of the 1980s was 12 percentage points below the figure for France and Germany, but reached the value of the German ratio by 1992.

service the debt: between 1990 and 1997 interest payments stayed constantly above 10 per cent of GDP.

Lower taxes for all! In the two decades of predominantly centre-right government a series of tax reforms have been passed. Fiscal amnesties (several waves since 1994) and no-prosecution for those returning illegally exported capital (fiscal shield 2010), elimination of the inheritance tax (2001) (reintroduced by the centre-left government in 2006 for the very largest properties), abolition of the local tax on first homes (2008) (which represented local authorities' most important source of revenue) on the one hand, and introduction of a social card for families below the poverty level, extension of the no-tax area and increased allowances for lower income families (minimum pensions, one-off allowance for the first baby) on the other, are the main pillars of fiscal and social policy.

But even lower to some. Toso, Baldini and Morciano (2007) have assessed the distributive effects of the fiscal reforms of the Berlusconi II government (2001–2005): they estimate that 2 per cent of the total fiscal advantages accrued to the 10 per cent at the bottom of the income distribution, while 20 per cent have gone to the 10 per cent at the top. All in all, more than half of the total fiscal benefits have gone to the top 40 per cent.

Lower taxes demand spending cuts to keep the deficit within limits. Social spending – education, research, social services and so on – have been at the forefront of any financial law aimed at coping with the umpteenth financial crisis; in fact, badly needed social reforms did not even take off: no support to families for child care and long-term care for dependent people, no policies for young people, no minimum income for the needy and no equal rights to protection. Of the much trumpeted flexicurity, only the first part was implemented, with gusto. Personal services have continued to rely almost solely on the family and the (irregular) market. This was made the government's official policy in the White Book of the Minister of Labour, Health and Social Policy (Ministero del Lavoro 2009), which has put the family firmly at the centre of welfare.

Italy is now at the bottom among OECD countries (together with the United States, Portugal, Poland and Turkey) for income equality (as measured by the Gini coefficient). With poverty in the south of the

country four times the level in the north, the persistent wide north–south divide is one important factor. There is a widespread perception of a sharp increase in families' impoverishment and precariousness that is not to be found in the statistics. In fact, since its drastic drop in early 1990s, the aggregate poverty index has remained fairly constant. This suggests that a change in the horizontal distribution of income among social classes (or functional income groups) may have occurred: self-employed, managers and pensioners have improved their position relative to employees (blue- and white-collars alike). The income distribution has become, if possible, even more fragmented and unequal also within wage earners, with enormous and increasing wage gaps between young and older workers and a soaring share for top incomes.³ Thus, a composition effect is concealed behind the stagnation of the average wage: a slight increase in the wage of regular workers on open-ended contracts in fairly protected sectors, compensated by an increase in low-paid irregular jobs and in sectors paying lower wages (Birindelli 2011).

To conclude, through tax evasion, tax elusion and tax cuts fiscal policy had three main effects: perverse redistribution, erosion of the basis for financing social policies and the unleashing of a political race that made tax reduction a bipartisan policy objective.

3. The crisis: reinforcing the features of the model?

Production. Following a long period of low growth, the sudden collapse of industrial production caused by the global recession dealt firms a terrible blow. Italy recorded the most precipitous fall of the Euro area index and the weakest rebound: the cumulative loss of GDP from peak to trough 2008–2009 wiped out the small progress of a decade, taking Italy's GDP back to its level in the fourth quarter of 2000 (Bugamelli *et al.* 2009b). The blow has been particularly severe for those sectors that had been at the core of the process of restructuring: in the engineering industry, one of the most dynamic export sectors, exports fell by 19 per

3. Between 1993 and 2004 the income of the top 0.1 per cent grew by 40 per cent; the income of the top 0.01 per cent grew by 75 per cent; 40 per cent of earners in the top 0.01 per cent are employees (top managers and superstars).

cent, and value added at constant prices by almost 30 per cent relative to 2007. The high correlation with the German industrial recession shows how deep the integration between the two economies has grown. While orders abruptly vanished, firms endeavoured not to let their skilled workforce go, resorting massively to the Cassa Integrazione (an institution aimed at providing income assistance for temporarily suspended employees, in essence a system of subsidised labour hoarding). Paradoxically, the credit crunch that followed the financial and banking crisis hit first and foremost those firms that had started a process of restructuring, and, in the brief season of growth that just preceded the crisis, had committed themselves to a programme of investment (Bigarelli and Russo 2011).

Following the German and world recovery, Italian exports have rebounded (by 15.8 per cent in 2010), but less than imports (23.4 per cent).⁴ Also, the index of industrial production has bounced back, but less than the index of sales (De Nardis 2011). These data suggest that the crisis may have inflicted heavy damage on the industrial fabric. Vanishing orders and the credit crunch have strained long-tested, trust-based inter-firm relations: previously outsourced production had been internalised again to ease the fall in production, and delocalisation had been speeded up to reduce costs. Plant closures resulted in the hollowing out of the value chain. Restoring trust within the sub-contractors' chain, mending the holes in the chain, restoring relations with old and new customers, finding a place within the new division of labour that Germany is devising, between competition and complementarity within the German area of influence, the near (European) East and the Far East, are the new challenges facing Italian firms.

Employment and unemployment. Unemployment did not increase dramatically thanks to wide use of the 'Cassa integrazione guadagni'. Employment reduction hit temporary workers first but, with no clear signs of an upturn, it is now denting open ended contracts as well. Female employment was relatively shielded at first, but the new phase of the financial crisis, raiding the sovereign debt of the Eurozone

4. Italy's world market share fell to 3 per cent in 2010, down from 3.3 per cent in 2009, while import penetration in manufacturing increased by 3.3 percentage points to reach 33.3 per cent (Istat 2011b).

countries, shattering confidence in the public debt and forcing government after government to implement austerity measures, is taking a toll on female employment. Thus, although women fared better during the financial and real crises, they are now succumbing to the effects of the fiscal crisis and the various, desperate attempts at fiscal consolidation. Young people are the gravest casualty, however. Italy is 'no country for young men' (to turn Yeats on his head): they are mostly employed on atypical contracts and they were the first to drop out of the labour market. In 2009, the reduction in temporary employment (by 11 per cent) accounted for the whole of the employment reduction (by 1 per cent). From a low of 20 per cent in 2007, the unemployment rate of young people aged 15–24 climbed to almost 30 per cent (against an average unemployment rate slightly below 10 per cent). This figure conceals large underlying inequalities: in the south the employment rate of young people aged 15–34 is 31.7 per cent as against 56.5 per cent in the rest of the country; two out of three youngsters are out of work, 30 per cent of young people under 34 with a university degree do not work nor study (Svimez 2011). A pervasive underground, irregular and illegal economy, made worse by a flow of irregular migrants, undermines local labour markets, erodes tax revenues and undercuts regular workers and businesses.

New industrial relations. Recent years have seen several attempts aimed at weakening the trade unions, by isolating CGIL, the main left-wing trade union confederation. On 22 January 2009 a 'separate' agreement between two of the three main trade union confederations (not signed by CGIL) and Confindustria (the Confederation of Italian Industry), with the backing of the government, refreshed the 1993 agreement and introduced new rules for wage indexation at the national level, while leaving to the second level (firm level) the distribution of productivity gains. In a round of negotiations at the plant level, Fiat imposed a new contract that introduced elements that departed from the national contract. The bargaining for the new rules took place under emergency conditions and under threat of relocation (to Poland and Serbia). Once again the agreement was not signed by CGIL. In the heated debate that accompanied and followed the negotiations, Fiat opted out of the collective agreement through the establishment of a new company: New Fiat. The question is whether, under pressure of the global crisis, the new model of industrial relations successfully imported into Italy from the United States by Mr Marchionne – Fiat's

CEO – is likely to spread.⁵ On 28 June 2011 a new inter-confederal agreement, regulating the conditions under which the firm-level agreement can derogate from the national contract,⁶ was signed by the three main trade union confederations. Although fiercely contested from within CGIL, this agreement might mark an end to CGIL's isolation.

From welfare to 'bankfare': financial crisis and fiscal consolidation. Although, in contrast to other countries, no expansionary fiscal measures were implemented to counteract the effects of the crisis, the collapse of GDP has inflated the debt/income ratio. The new financial environment, disrupted by uncertainty and speculation, destabilised by a huge public debt, the legacy of past profligacy and fiscal irresponsibility, makes fiscal sustainability difficult. Tax increases are not politically and economically feasible: the sheer size of tax evasion means a very high tax rate for those who pay, and one of the highest tax wedges in the EU.⁷ The combination of tax evasion and the need for fiscal consolidation has made it impossible to finance any scheme of income support in the crisis, while leaving further cuts in services as the only remaining option. The financial law of December 2010 and the Austerity Budget passed in July 2011, after a speculative attack on government bonds sent the spread over the Bund beyond the threshold of 300 basis points, were made up mostly of spending cuts:⁸ reduction in transfers to regions and local authorities, cuts in social expenditure (the national fund for social policy has been decimated and the fund for people unable to look after themselves ['non-self-sufficient'] cancelled, to name only a couple), with the regions made to bear all the cuts. Under the unremitting attack of the financial markets, the ECB pressured Italy's recalcitrant government into another austerity package: this time the bill, passed in September 2011, was based mostly on strongly regressive tax increases.

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5. Labour market changes in the direction of greater flexibility are among the measures set out in the letter sent by the ECB in August 2011 and that the Italian government must take as a condition for the ECB's support of the Italian bond market.
 6. Another important aspect of the agreement concerned the issue of representation.
 7. It has been estimated that tax evasion deprives the Treasury of 120 billion euros in revenue each year. When taking tax evasion into account the effective tax rate (tax plus social contributions) borne by those who pay soars to 51.4 per cent (Mobili and Pesole 2011).
 8. However, a large part of these cuts, and especially those cutting cronyism and the privileges of the political class, were postponed to 2013, after the elections!

Without resumption of growth, the stabilisation of the debt/income ratio will require further cuts in public spending (on current and capital accounts). However, with no growth, no work opportunities for young people, cuts in public services, stealthy increases in taxes and fees, speculative rides on bonds that shave their values, the proverbial wealth saved by Italian families over the years (often mentioned as acting as collateral for sovereign debt) is rapidly dwindling. The Bank of Italy is warning of increasing financial stress amongst Italian households, while the national statistical office (Istat 2011a) reports that 11 per cent of households are in relative poverty and 4.6 per cent in absolute poverty (23 per cent and 6.7 per cent, respectively, in the south). The north and the south of the country are drifting apart: while the north is toiling to restore its ties with Continental Europe (read: Germany), the south is adrift in the Mediterranean. Although the financial crisis seems to have frozen, for the time being, the implementation of federal reform, no concrete measures are being put forward to halt the slide.

4. What is to be done? The PIIGS and Europe

Macroeconomic effects of EMU. We can now see that, given the enormous distance separating the economic and political institutions of the Nordic-Continental countries from those of the European South, it was a mistake for the Mediterranean countries to enter a monetary union without a fiscal and political union. Survival of the weak in a currency union requires solidarity,⁹ something that has never abounded within the European Community and a very perishable quality indeed. It is now fashionable to say that economists have warned, since the very beginning, of the very demanding conditions required for a currency area to work properly. It is fair to say, however, that for a long time mainstream economists and politicians alike have let themselves be carried away by the 'convergence play', seriously underestimating the risks and costs inherent in wage and price flexibility as a pre-requisite for convergence.¹⁰

9. See the estimates of the federal transfers in the United States in *The Economist* (2011).

10. See Simonazzi and Vianello (1998) for an early warning.

Is it still possible to save the common currency? This begs two questions. First, is there a common interest linking surplus and deficit countries and capable of supporting a commonality of policies? Can we conceive of and create a political entity to take care of Europe? Second, are there reforms that the southern countries should implement on their own in order to make the common currency a viable policy for them, besides reforms/policies that require a common design? Let us start with the latter.

Italy: delayed reforms and (misguided) policies. Let us try to sum up the main drawbacks dealt with separately in previous sections. An increasingly unequal income distribution, no longer mitigated by redistribution through the public budget, which on the contrary is working perversely. Cronyism, corruption and bureaucratic inefficiencies holding back growth. A fiscal consolidation policy attained by cutting social and capital expenditure and regressive taxation, undoing the modest welfare state that had been constructed. The lack of any industrial policy capable of assisting firms in their process of restructuring, and a policy of industrial relations aimed at driving a wedge between the trade union confederations (that only recently seems to have been toned down). Finally, a political stalemate, with a divided majority held together only by the desire to remain in office, and a left locked-in by its perceived impossibility to advance solutions that demand a redistribution of income and bold reforms to clean out cronyism and corruption.

This is not an exhaustive list, nor is there a lack of alternative explanations for the Italian malaise.¹¹ While there is agreement on some fundamental points – the dysfunctional role of the bureaucracy, the deterrent effect of high taxes (for those who pay them), the existence, within the public budget, of large pockets of privilege and waste – the main difference, and not a small one, concerns the idea that it will suffice to unfetter entrepreneurship to restart growth. The corollary is: the sooner, the better. No need for a gradual approach to debt reduction, no need to worry about the deflationary effects of balancing the budget (Perotti and Zingales 2011).

11. *The New York Times* (Alderman 2011), *The Economist* (various issues) and economists in the financial newspaper *Il Sole 24 Ore* (for example, Perotti and Zingales 2011) have offered their own explanations and suggestions.

An alternative policy must be based on the tenet that aggregate demand must increase in order to create new job opportunities, and public (physical and human) infrastructure needs to be part of it. The tax base must be more equally spread and service provision must improve. This calls for a solution to the quandary of public employment and bureaucratic inefficiency. The concept of taxes must be connected again with the concept of services: people need to relearn that what they pay is for their health, education, kindergartens and elderly care. We need an industrial policy to identify the direction of development, guide investment, endeavour to ensure that the increase in demand does not leak out in imports (learning from the 'bad practices' of the green energy policy and the measures in support of car scrapping¹²) and devise means to support the upgrading of value chains. New industrial relations and the revision of labour market deregulation are also needed. One good thing that this crisis might have produced is to convince Italians that the country is at present on a road to ruin and that there is no external (European or German) nor individual (devolution, Lega Nord) salvation.

Only once we have done our homework can we seek, and demand, Europe's help.

Too little, too late. In the midst of the 'tsunami' that wrecked the financial markets, creating a panic among savers and inundating the sovereign debt and banking systems of half of the Euro area countries, 'a controlled process of successive, agreed steps' was deemed the right answer. For too long the EU leaders, led by Angela Merkel, refused to acknowledge how interwoven national financial institutions had become. The leadership vacuum, lack of statesmanship and conflicting national interests have systematically prevented the timely adoption of those measures that were later forced upon them by a new, ever deeper crisis. Although the plan agreed upon at the end of July to 'insulate' the Greek crisis represented a big step towards greater risk sharing, it was not enough to prevent a much bigger crisis from breaking out. And again, when in September 2011, after excruciating negotiations, the German Parliament eventually

12. In 2010, imports of electronic components jumped by 211.2 per cent, largely as a consequence of the energy saving incentives on the demand for solar panels (Istat, 2011b). In fact, these incentives were not linked to a policy supporting the firms active in the sector.

approved expansion of the Eurozone bailout fund (the European Financial Stability Facility), it had already been overtaken by events. Meanwhile, austerity is killing growth throughout Europe and European leaders' lack of vision and resolve is scaring the world. It is possible that, when enough damage has been inflicted on the Eurozone economies and the European institutions' credibility, more coordinated efforts – whether it be the idea of 'Blue Bonds' or a European Marshall plan, backed by all the euro economies – will be forced onto the agenda. But if conditions keep deteriorating, a point may be reached at which not even a willing Germany would be able to pay the bill for everyone.

Even if the debt crisis can be overcome, the fundamental question of how to ensure convergence of economies that are still so different and far apart remains open. How long, in fact, will the southern countries be able to endure the deflationary policies that are required to restore competitiveness (even if we assume that they will be able to attain equal productivity growth), if low German inflation demands negative changes in their wages and prices? Besides negatively affecting growth, declining wages and prices will exacerbate the problem of the public debt. History teaches us that the consequences of a general deflation can be disastrous.¹³ Europe must resume growth if the countries of the periphery are to have a chance to grow out of their debt. This inevitably calls into question Germany's policies. For German voters, their country's post-war economic miracle was built on a hard currency, prudent finances and strong exports. It is hard for German voters to fathom that these very virtues are at the heart of the current crisis (Knight 2011). As noted by Gordon Brown, 'There is some truth in the argument that Germany will only agree to become a bigger part of the solution when faced with the evidence that it is also a big part of the problem' (Brown 2011). Emergency intervention needs to pave the way for long-term construction: a growth strategy that would mean easing up on austerity for Greece and the other weakened countries and enacting stimulus measures in surplus countries, as well as new rules that prevent the formation of the very disequilibria that led to the present predicament.

13. The economic and social costs involved in having to adjust (downward) the level of prices and wages to fit an (overvalued) fixed exchange rate have been illustrated by the UK experience of the return to gold at pre-war parity in 1925–31.

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Spain: the nightmare of Mediterranean neoliberalism

Josep Banyuls and Albert Recio

1. Introduction

After a long period of dramatic growth the Spanish economy is now among the group of European countries hardest hit by the economic crisis. The discussion on the reasons for this situation and requisite policy response is intense, with wide variations of opinion. From the conventional point of view, the crisis is mainly a market disequilibrium problem. Others believe that there are structural reasons. In this chapter, taking into account the particularities of Spain's employment model, we present the central topics that, in our opinion, explain the underlying causes and characteristics of the crisis. We also analyse its consequences and the political responses of the government.

In the national arena, the labour market is one of the most significant questions. As in the previous crisis, mainstream economists have identified labour regulation as one of the main reasons for the crisis. Their proposed responses therefore concern labour market deregulation. These explanations and proposals are discussed in particular in Section 4. In the conclusion we point out some lessons learned from the crisis and present some ideas about possible alternatives and future prospects.

2. A foreseeable crisis

Halfway through the past decade, Spanish economy appeared to be successful in many aspects: it was experiencing a decade of sustained growth in production output and employment, women were gradually being incorporated into the labour market and unemployment was going down. However, when the analysis goes deeper than these primary indicators, the situation appears to have been more complex

and disturbing. This is why, against this backdrop of prosperity, there were those who said that despite modernisation and temporary success, Spain's growth model was extremely fragile (Banyuls *et al.* 2009).

Table 1 Selected economic indicators, Spain, 2001–2010

	GDP (annual change %)	Gross fixed capital formation (annual change %)	Current + capital account (% GDP)	CPI (annual change %)	Government deficit/surplus (% GDP)	General government gross debt (% GDP)	Employment LFS (annual change %)	Unemployment rate (%) ⁽¹⁾
2001	3.6	4.8	-3.1	3.6	-0.6	55.5	4.1	10.6
2002	2.7	3.4	-2.2	3.1	-0.5	52.5	3.0	11.5
2003	3.0	5.9	-2.5	3.0	-0.2	48.7	4.0	11.5
2004	3.2	5.1	-4.2	3.0	-0.3	46.2	3.9	11.0
2005	3.6	7.0	-6.5	3.4	1.0	43.0	5.6	9.2
2006	4.0	7.2	-8.3	3.5	2.0	39.6	4.1	8.5
2007	3.6	4.6	-9.6	2.8	1.9	36.2	3.1	8.3
2008	0.9	-4.4	-9.2	4.1	-4.1	39.7	-0.5	11.3
2009	-3.7	-16.0	-5.1	-0.3	-11.1	53.2	-6.8	18.0
2010	-0.1	-7.6	-3.9	1.8	-9.2	60.0	-1.3	20.3

Note: (1): In 2005 there is a break in the series due to a methodological change.

Source: La Caixa, *Informe Mensual*, Ministerio Economía, *Síntesis Indicadores Económicos*; Banco de España, *Boletín Estadístico*.

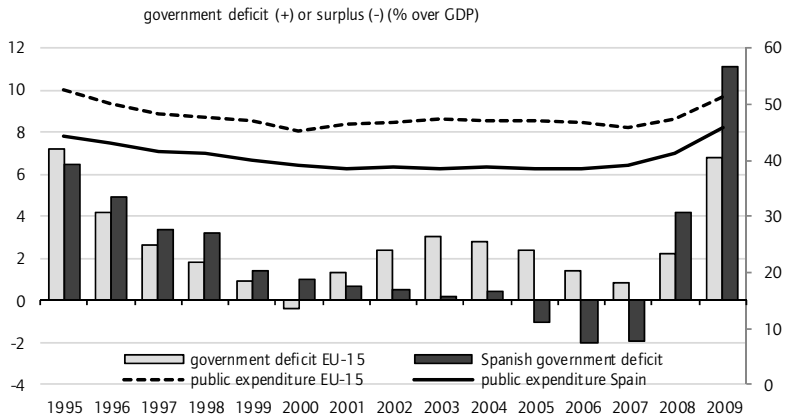
Some reasons for this instability were deeply rooted in the model of development of Spanish capitalism during the Franco era. It was largely a closed economy whose opening up since the late 1970s has been turbulent. Other aspects could be explained by the accumulation of contradictions in Spanish democracy (since 1977), notably the way in whether the internationalisation of the Spanish economy has come about and the contradictory attempt to apply neoliberal policies in a society that was trying to develop a – previously non-existent – welfare state. Other contradictions have arisen during the latest phase of rapid development (from 2004), bringing about an extremely risky situation.

The first major source of problems is the production model. The Spanish economy repeatedly experiences deficits in its external trade (Pérez *et al.* 2004), leading to endemic external debt and hindering job creation. This deficit reflects persistent low competitiveness, mainly in industry, but also disequilibrium associated with dependency on basic inputs (especially energy). This situation was aggravated after EU entry due to the persistence of moderate deindustrialisation. This can be explained by a combination of factors: the small and limited technological development of Spanish companies (making internationalisation difficult), the limited scale of local plants (which has justified their closure when supranational industrial groups have undertaken reorganisation), specialisation in mid- and low-level production (more prone to relocation to countries with lower salaries) and foreign control over the main industrial groups.

Furthermore, large domestic capital owners (especially the financial sector) opted to discard their industrial interests and focus on the financial sector, public works and privatised public services (Recio 2010). Only tourism and some agricultural segments can be considered successful sectors of specialisation in the international arena, but they have not been sufficient to balance out the problems created in manufacturing. Until the beginning of the 1990s the imbalances were tackled with successive devaluations, but since euro entry this option has been unavailable and the latest phase of expansion has led to a growing deficit and increasing indebtedness.

The other big ‘failure’ of the system is found in the role of the public sector. Historically, Spain was a country with low taxes and a small welfare system. The democratic transition implied substantial changes, with the introduction of a modern tax system and the extension of public services. However, this expansion was always limited by the country’s lax mentality towards tax and great tolerance as regards the unofficial economy. Since the early 1990s, a series of tax cuts have been instituted that contrasted with the greater social demand for public health services, education and so on. This was partly linked to the competition between the two dominant parties in the political arena. In this case, the tug-of-war between revenue and spending gave rise to underdevelopment of the public sphere rather than financial deficits. This shortcoming in particular affects the household/family system that has to take on an enormous burden with few resources.

Figure 1 Government deficit and public expenditure, Spain and EU15, 1995–2009



Source: Eurostat and CCOO from IGAE.

The phase of spectacular economic growth from 1994 to 2007 masked these problems instead of solving them and, to some extent, aggravated them. In terms of production, the engine of this growth was undoubtedly construction, above all in the residential sector but also public works. The impact of this industry on all economic activity was unquestionable (Bielsa and Duarte 2011). The nature of this activity, which cannot be relocated, extended its impact across the country, although tourist and urban areas experienced the biggest growth. The enormous building activity boosted employment and tax revenues, but one of its downsides was the explosion of mortgages taken out by households throughout the country.

At first, this led to a financial bubble and severe household indebtedness, not to mention a serious problem of access to housing for lower earners (especially young people). The financial sector played a crucial role in this, taking loans from abroad to transform them into loans for property developers and individual buyers (Naredo and Montiel 2011). This explains why Spain's external debt has been mostly private debt. Second, it has led to serious environmental degradation, accelerating some existing problems (desertification, energy dependence and so forth). Third, as this is an activity in which government regulation plays a key role in classifying land, this industry became the main agent

responsible for the problems of political corruption, especially at local level. The building boom encouraged an economic mindset of short-term profit based more on property transactions than on the pursuit of technical efficiency, training and improved competitiveness (Lopez and Rodriguez 2011).

Table 2 Employment by activity, Spain, 1994–2007

	1994	2007	% of change	'000 (only positive change)	% over total change (only positive change)
Total activities	12,207.6	20,476.9	67.7	8515.0	100.0%
Agriculture, hunting and forestry	1,064.2	856.9	-19.5		
Fishing	82.2	48.9	-40.5		
Mining and quarrying	59.4	54.1	-8.9		
Manufacturing	2,427.0	3,118.9	28.5	691.9	8.1%
Electricity, gas and water supply	90.8	106.1	16.9	15.3	0.2%
Construction	1,117.2	2,693.5	141.1	1576.4	18.5%
Wholesale and retail trade; repair of motor vehicles...	2,108.9	3,211.5	52.3	1102.6	12.9%
Hotels and restaurants	738.0	1,443.8	95.6	705.8	8.3%
Transport, storage and communication	712.0	1,176.3	65.2	464.3	5.5%
Financial intermediation	329.5	509.3	54.6	179.8	2.1%
Real estate, renting and business activities	633.0	2,054.0	224.5	1421.0	16.7%
Public administration and defence; compulsory social security	789.6	1,241.3	57.2	451.7	5.3%
Education	670.6	1,128.0	68.2	457.4	5.4%
Human health and social work activities	616.0	1,221.0	98.2	605.1	7.1%
Other community, social and personal service activities	433.7	842.1	94.2	408.5	4.8%
Activities of households	334.6	770.0	130.1	435.4	5.1%
Activities of extraterritorial organisations and bodies	1.3	1.2	-7.7		

Source: Authors' calculations from LFS. Annual averages.

The growth of the property market also had a complex impact on public policies, which were contradictory. On the one hand, the policy of tax cuts was accelerated under both the conservative Partido Popular and the Socialist Party (reforms of income tax and corporate tax, elimination or reduction of taxes on inheritance and donations, and so on). In the short term, the buoyancy in the property market compensated for the loss of revenue due to tax cuts, but when the property market slumped, tax revenues plummeted. Moreover, with the Socialist Party back in power a new boost was given for the welfare policies that people demanded, not only in traditional matters such as education and health care, but in new areas, and especially in aid for housing and policies aimed at families and dependents. One especially clear example of the increase in spending is found in the budgets in the autonomous regions to which management of social spending had been transferred. Behind this increase there was both the need to improve the standards of public services and the demographic and social backdrop which is discussed below.

The traditional Mediterranean family model is based partly on distinct gender roles that have enabled many reproductive needs to be covered by female household members (although there is increasing evidence that this activity is often combined by many working-class women with unofficial paid employment). This model has partly broken down (Miguélez and Recio 2010) due to the changes that Spanish society has experienced in recent years: an increase in education, especially for women, changes in consumption patterns (which make a single family income unfeasible) and the increasing instability of the traditional family model (growth of the divorce rate and short-term informal relations). In addition, the aging population is giving rise to new care that families alone are unable to sustain. All of this pressure has led to demand for new social policies to support families and the creation of new labour market demand for care workers which, due to families' financial constraints, has generated an 'unofficial market for carers' (Simonazzi 2009).

All this resulted in strong employment growth for years. This employment growth soon required the mobilisation of a large reserve workforce, however, which explains the intense immigration to Spain.¹ This immi-

1. The employment growth has been taken place at the same time that the labour force has increased, with the arrival of immigrants and higher female labour market

gration occurred alongside policies that were fairly lax as regards entry into the country, while labour law within Spain was very restrictive. The result was that at several stages during this process this reserve workforce found itself in a situation of illegality or outside the law, which in turn fostered the growth of unofficial employment. At least this wave of immigration made a quantifiable contribution that enabled companies to cover their labour needs without generating inflationary pressure on wages. It often contributed to a deterioration in working conditions, however, particularly in sectors where unofficial labour is particularly prevalent (especially the care sector, but also outsourcing in construction or services). Population growth also helped to generate demand for increased public services, which also explains some of the policy responses.

The financial system has played a central role in developments. In the crisis of 1975–85 the private banking system was restructured (with generous state support) and was subjected to stricter regulations with regard to reserves. As a result, in the current crisis they have not experienced problems of the same magnitude as in other countries. As an effect of these processes, the private banking system became more concentrated (now there are only two big banks, Santander and BBVA, instead of six, plus two medium-sized banks) and the whole sector has successfully protected itself against the competitiveness of foreign banks. The biggest two banks have engaged in internationalisation (mainly in Latin America and the United Kingdom), reducing their dependence on the domestic market. On the other hand, there is a large group of savings banks, usually with the participation of local governments, mainly geared towards local markets. Both groups based their expansion on the massive use of foreign credit. A large part of these funds, especially in the case of savings banks, was devoted to feeding the real estate and housing bubble. When the bubble collapsed,

participation. Despite the dramatic economic growth the unemployment rate in this period was still high compared to other European countries. This is due to several reasons, three of which are particularly significant. One is job quality. Most of the jobs created in this period are 'bad' jobs, and people that can avoid them continue to look for a better one, remaining unemployed in the meantime. Bad jobs have been taken mainly by immigrants. The second is the high level of flexibility of the Spanish labour market, with a high level of replacement due to the intensive use of fixed-term contracts. Many workers move from employment to unemployment and back again very often. The third aspect is the fact that, despite the significant employment creation, in some activities (some industrial branches, agriculture) there has been slow and continuous employment destruction, and those affected have found it very difficult to find a new job.

savings banks faced major problems. Now they have been transformed into private banks or have been nationalised. It is important to take into account the fact that the problems of Spanish banks were not induced by their foreign activities, as in other EU countries, but rather home-grown, due to the domestic housing credit bubble.

In summary, the background of economic developments before the recession partly contributed to the conditions that dictated how it subsequently progressed: it promoted an economic development model focused on the volatile building industry, mobilised a reserve workforce in a very precarious social situation and weakened the country's tax base in a setting calling for higher spending. The recession has been worldwide, but the Spanish economy had accumulated sufficient features of its own to explain the dramatic situation we are now seeing.

3. Employment crisis and more neoliberalism

From the point of view of employment, the recession in Spain began in the fourth quarter of 2007. Since then, job losses have continued and the unemployment rate has risen to 21.3 per cent. As has happened before, the Spanish labour market has great elasticity when confronted with the vagaries of economic activity. In our opinion, this is due to the role of the building industry. This industry can adapt almost immediately due to its heavy use of temporary employment and the unique nature of each construction project. The construction industry provides an exaggerated example of the process of job destruction: it is directly responsible for 36 per cent of jobs lost since the beginning of the recession and for many of the jobs lost in industry. Some industrial branches unrelated to construction have also shed employment, however, such as the motor industry and some traditional activities.

However, this loss of jobs does not explain all of the increase in unemployment: 25 per cent of it is explained by the arrival of new people in the labour market due to an 'additional worker' effect due primarily to adult women. This is a new feature of the Spanish labour market (in previous recessions the entry of women was lower) and supply factors come into play (job losses affect especially men and, in some groups – for example, people from Morocco – the response to unemployment is the entry of adult women in the labour market).

Table 3 Employment by activity, Spain, 2008–2011

	Distribution by activity (%)		% change	Employment destruction	
	2008 Q1	2011 Q1		in thousands	as a %
TOTAL	100.0	100.0	-11.0	-3263.9	100.0
A - Agriculture, forestry and fishing	4.2	4.3	-9.3	-80.5	2.5
B - Mining and quarrying	0.3	0.2	-20.3	-10.8	0.3
C - Manufacturing	15.1	12.7	-25.1	-772.7	23.7
Manufacture of food products	2.2	2.2	-11.0	-49.3	1.78
Manufacture of textiles	0.4	0.3	-39.7	-34.9	1.26
Manufacture of wood and of products of wood and cork, except furniture	0.5	0.4	-34.9	-36.9	1.33
Manufacture of other non-metallic mineral products	1.1	0.7	-44.7	-97.6	3.53
Manufacture of fabricated metal products, except machinery and equipment	1.9	1.4	-35.5	-137.5	4.97
Manufacture of motor vehicles, trailers and semi-trailers	1.2	1.0	-21.5	-52.0	1.88
Manufacture of furniture	0.9	0.5	-48.5	-91.4	3.31
D - Electricity, gas, steam and air conditioning supply	0.4	0.4	9.5		
E - Water supply; sewerage; waste management and remediation activities	0.6	0.7	3.5		
F - Construction	13.1	8.2	-44.1	-1176.3	36.0
G - Wholesale and retail trade; repair of motor vehicles and motorcycles	15.7	16.0	-9.3	-299.2	9.2
H - Water transport	4.7	5.0	-5.5	-52.3	1.6
I - Accommodation and food service activities	6.8	7.2	-5.8	-80.8	2.5
J - Information and communication	2.6	2.7	-5.4	-28.4	0.9
K - Financial and insurance activities	2.5	2.5	-12.0	-62.0	1.9
L - Real estate activities	0.6	0.5	-21.9	-26.5	0.8
M - Professional, scientific and technical activities	4.3	4.6	-5.4	-47.2	1.4
N - Administrative and support service activities	4.5	5.0	-0.7	-6.0	0.2
O - Public administration and defence; compulsory social security	6.0	7.9	17.3		
P - Education	5.7	6.6	3.9		
Q - Human health and social work activities	5.8	7.6	17.3		
R - Arts, entertainment and recreation	1.4	1.8	14.2		
S - Other services activities	2.1	2.0	-17.1	-74.6	2.3
T - Activities of households as employers	3.7	3.9	-6.3	-47.0	1.4

Source: Authors' calculations from LFS.

Table 4 Selected labour market indicators, Spain, 2006–2011

	% of change				Rates		
	Older than 16	Active	Employed	Unemployed	Activity rate	Employment rate	Unemployment rate
All							
2006 Q1	1.7%	3.6%	4.9%	-7.8%	58.0%	52.7%	9.1%
2007 Q1	1.7%	2.8%	3.4%	-4.1%	58.6%	53.6%	8.5%
2008 Q1	1.6%	3.0%	1.7%	17.1%	59.3%	53.6%	9.6%
2009 Q1	1.0%	2.3%	-6.4%	84.5%	60.1%	49.7%	17.4%
2010 Q1	0.1%	-0.4%	-3.6%	15.0%	59.8%	47.8%	20.0%
2011 Q1	0.2%	0.2%	-1.3%	6.4%	59.9%	47.1%	21.3%
Male							
2006 Q1	1.9%	2.6%	3.7%	-10.0%	68.9%	64.2%	6.8%
2007 Q1	1.9%	1.9%	2.4%	-5.5%	68.9%	64.6%	6.3%
2008 Q1	1.7%	2.3%	0.6%	27.3%	69.3%	63.9%	7.9%
2009 Q1	1.0%	0.7%	-9.2%	115.6%	69.1%	57.5%	16.9%
2010 Q1	-0.1%	-1.8%	-5.5%	16.3%	67.9%	54.4%	20.0%
2011 Q1	0.0%	-0.8%	-1.8%	3.2%	67.4%	53.4%	20.8%
Female							
2006 Q1	1.5%	5.0%	6.7%	-5.9%	47.5%	41.7%	12.2%
2007 Q1	1.6%	4.0%	5.0%	-3.1%	48.6%	43.1%	11.4%
2008 Q1	1.6%	3.9%	3.2%	9.4%	49.7%	43.8%	12.0%
2009 Q1	1.0%	4.6%	-2.6%	57.1%	51.5%	42.2%	18.0%
2010 Q1	0.3%	1.4%	-1.3%	13.4%	52.0%	41.6%	20.2%
2011 Q1	0.3%	1.5%	-0.8%	10.5%	52.7%	41.1%	21.9%

Source: Authors' calculations from LFS (first quarter).

On the other hand, in the first stages of the recession some traditional feminised sectors continued to create employment (care) and contributed an oversupply of labour.

The response to this social upheaval has varied in accordance with how the process has unfolded and how it has been understood. As for the socialist government, two clearly defined phases can be distinguished. The first, until May 2010, was characterised by considering the crisis as a temporary economic downturn that should simply be overcome using measures dealing with current circumstances. To some extent, demand stimulus was applied: tax cuts (elimination of wealth tax, discount of

400 euros on income tax, aid for those with new-born babies) and expenditure (establishment of a new grant of 400 euros for the unemployed with no benefits, Zapatero's plan for municipal public works and so on). There was confidence that the Spanish economy was stronger than that of other countries, above all because of the banking system.

The government was aware of the need to change the production model and it presented a Sustainable Economy Act which was really a compendium of unrelated measures (from the promotion of renewable energy to the liberalisation of services), but it had no clear roadmap as to how to guide the changes. Adopting these policies did not prevent massive job destruction nor did it serve to change the direction of the economy. Tax relief measures had little effect as they did not focus on the low-income population. Perhaps the measures for maintaining expenditure have worked a little better. In any case, the economic system fell into serious recession by not being able to absorb the collapse of the portentous property bubble. The excess supply that was generated (especially as regards second residences) and the high level of household indebtedness (compounded by rising interest rates in 2008 and job losses) ended up generating a crisis in the financial sector and the collapse of public revenue.

This economic policy approach did not work (Arias 2009). The property crisis has dragged down the rest of the economy. First, it has involved the banking sector, which has had to deal with unpaid debts and assume ownership of a large amount of residential property. Second, the sudden drop in property transactions has led to a sharp fall in public revenues, causing the public deficit to grow rapidly. The Spanish economy's high external debt and the panic created among foreign lenders has fuelled a rise in external interest rates and put heavy external pressure on the Spanish economy. Then there is also the high social cost of millions of unemployed who have lost their homes and are facing unpayable debts. In this context, the government performed a strategic u-turn in May 2010, fully accepting a programme of budget adjustment and structural reforms with a neoliberal bent:

- cuts in public spending, starting with a reduction of 5 per cent in public sector wages, freezing pensions and eliminating the previous tax breaks for employees;

- structural reform of the labour market (September 2010, August 2011) concerning collective bargaining (June 2011), public sector pensions (February 2011) and the financial system, especially savings banks (see Box 1);
- privatisation of other parts of the public sector: lotteries, airports; the reform of savings banks also included converting them into private banks with public money, once their finances had been given a clean bill of health;
- modification of the Constitution (September 2011), including the payment of public debt as the first priority of public budgets and constraining (in 2018) the maximum public structural deficit to 0.4 per cent of GDP.

In addition to these national policies, the autonomous regions have also been active. The latter are now responsible for managing education, health care and social services – these services were transferred from central government without adequate funding – thereby also transferring pressure on public deficits to the regions. Some, such as Valencia and Madrid, have been applying neoliberal management of these services for years, while others, such as Catalonia, have now become completely geared towards neoliberal policies: budget cuts and private management of services are part of the model.

As for the fiscal crisis, on the other hand, no tax reform measures have been put forward that would bring in more revenue to the state budget and reduce the unequal tax treatment that affects the population according to income level and source of income. While labour creates income accounting for less than 50 per cent of GDP, it bears more than 80 per cent of income tax. The experience of the recession indicates that too little has been done to restructure production – of course, this is very difficult (AAVV 2009) – while implementation of the neoliberal agenda has continued. Neoliberal principles have little to offer as regards correcting the weaknesses in the economic model.

Box 1 Structural reforms in Spain

Reform of Labour Act (September 2010)

- Expands the range of causes that justify 'fair' dismissal (the expectation of future losses is considered a fair cause).
- Introduces state aid for firms for compensation for fair dismissals (state will pay 40 per cent).
- Enlarges the potential number of workers with reduced compensation (from 45 days per year worked to 33) for 'unfair' dismissal (unjustified, automatic, without pre-notification).
- Introduces a new scheme of working time reduction.
- More possibilities for individual firms to opt out of sectoral collective agreements.
- Increases redundancy pay for temporary employees from 8 to 12 months.
- Allows employment agencies to operate in more sectors (for example, construction) and to cooperate with public employment services.

Reform of collective agreements (June 2011)

- Introduces a mandatory term to renegotiate agreements when they expire; at the end of this term introduces the mandatory arbitration.
- Introduces mandatory items on internal flexibility in collective agreements.
- Allows firms to opt out of sectoral collective agreements and promotes the extension of company agreements.

New measures on Labour Market (August 2011)

- Expands the training contract (for people without basic qualifications) until the age of 30. This contract includes 20 per cent of time in formal training, and is paid at the minimum wage. At the end of the contract (1–2 years) firms will be subsidised for hiring the people concerned.
- Allows firms to renew temporary contracts with the same employee indefinitely. Formerly, there was a two-year limit.

Social security (February 2011)

- Retirement age will increase from 65 to 67 years old.
- The age of voluntary pre-retirement will rise 61 to 63 years old.
- Maximum pension will require 37 years of contributions (previously 35).
- Pensions will be calculated on the basis of the last 25 years of contributions (previously 15 years).
- Time devoted to maternity (maximum 2 years, 9 months per child) and post-graduate study (maximum 3 years) are included in contributions.
- Revision of the scheme every 5 years.

Financial sector

- Transformation of former savings banks into banks and promotion of concentration.
- Bank capital must be 8 per cent of their total assets (risk weighted); 10 per cent for new savings banks without external owners.
- Creation of a fund (FROB) to finance the restructuring of financial groups by means of credit. The FROB can take temporary ownership of these companies. In the end, they are to be reprivatised.

4. The labour market: eternal reform

One significant feature of the structural reforms being carried out is the change in the employment system. This has been a constant in Spanish history since 1980. Labour market reform is continuing as much because of the varying interpretations of influential academic and social groups, as because of Spain's real problems in this area.

The high unemployment rates in Spain recurrently give rise to a reductionist reading that suggests that unemployment is primarily a problem of labour and that structural reform is necessary to decrease it (Andrés *et al.* 2010; Dolado and Felgueroso 2010). Empirical evidence suggests, however, that the creation and destruction of employment in Spain has much more to do with expansionary and recessionary phases of the business cycle than with existing regulations. Nevertheless, the argument based on alleged rigidities in the Spanish labour market reappears prominently every time the country suffers mass unemployment. This view is held consistently by leading think tanks in the country: the Bank of Spain Centre for Studies, the FEDEA Foundation (funded by big business) and business organisations. The rigidity argument is related to a strict dual view of the labour market (protected permanent employees in one side, temporary ones in the other). This view has been discussed by other authors with a more complex view of the labour market (Prieto *et al.* 2009) based on segmentation, not to mention the current trade union approach to wage claims (Perez Infante 2011). There is also evidence of increasing inclusion of flexibility in collective agreements (CES 2008, 2009, 2010).²

2. The discussion on rigidity in the Spanish labour market is complex. Usually, it centres on the existence of highly protected permanent workers, but the real question is the provision in Spanish law that allows firms to dismiss workers with no need to justify their decision and without any announcement period, although at high cost (45 days per year worked). If firms do justify the dismissals the cost is much lower (and with the reform the dismissal cost in a permanent contract can be the same as in a temporary contract), but employers tend to use the expensive formula because it is more flexible. Other aspects that confer on the labour market a high degree of flexibility are the diversity of collective agreements (at sectoral and territorial level), the extended use of outsourcing, the large proportion of small firms (which are not subject to certain collective agreement items), the lack of professional recognition that gives firms significant flexibility in the use of labour, the tolerance of informality and so on.

The current reform package deals mainly with three areas (Cruz 2010; García *et al.* 2010): individual contracts, labour market brokerage and collective bargaining. In terms of job contracts, the new reform introduces new measures to facilitate job dismissals and layoffs and to make them cheaper, for both groups and individuals, on the assumption that the high cost of this hinders job creation. Among the various provisions in this measure, there is the government subsidy to employers for legal lay-offs that if applied would cover the costs of all kinds of dismissals (apart from unfair dismissal) for up to 12 days per year worked. In terms of brokerage, the most important innovation is that it enables temporary employment agencies to operate in virtually all industries (previously, this was banned in some areas, such as construction) and allows brokerage in the labour market to be outsourced to these agencies. This measure is yet to be developed, but it may have a significant effect.

The most radical change seems likely in collective bargaining. This change is aimed primarily at reducing the valid duration of agreements once they have expired, setting maximum time limits and the mediation of an arbitrator to impose a final solution when there is no agreement. The reform also seeks to promote bargaining at company level and less reliance on negotiated agreements above the industry level. This is potentially a radical change because in a country dominated by small and micro enterprises it opens up the possibility of a labour market in which the only real collective bargaining may take place in a small number of companies. This is a path that once again moves along the lines of encouraging low wages as a basic strategy for profitability and competitiveness. It is a path that Spain has been down in the past and probably explains the way production and society is oriented, which is at the core of the problems in the Spanish economy.

This recession seems to show a new twist in a policy with which Spain has long been associated. The plausibility of this policy rests on the fact that unemployment causes massive social demand for urgent solutions and labour reforms are presented as the first medicine to be taken. Its proponents tend to forget the other features that explain Spain's high unemployment. In fact, they apply the old partial analysis that Keynesians debated over 70 years ago. As a result, they impose measures which, until now, have proved effective only within the framework of a production model characterised by limited technological development and capacity for innovation, low cooperation and low labour recognition.

Perhaps what is new in the current recession is that this model, which has been especially effective in areas of manual employment, is being generalised to the entire labour market.

Overall, the changes that have taken place during the recession reinforce the dominant features of the previous model. No changes are proposed in the structure of production and the focus is being placed on increasing labour market flexibility by means of low wages. It is significant that the reform of vocational training has come to nothing, while reforms are in progress to allow greater wage dispersal. Likewise, the adjustment plans based almost exclusively on cutting costs do not foster employment or solve Spain's social deficits, nor do they help the traditional family model to adapt to new work requirements and demographics.

5. Lessons learned and prospects

The recession in Spain is not merely a matter of cyclical ups and downs. It has tested the fragility of our employment model and the need for profound transformation. It is clear that the measures being adopted – and which the conservative government emerged from the last general election is expected to take – will not entail a radical change compared to the previous situation. Instead, the current situation indicates the persistence of the same model of action and strong dependence on the past. This dependence is due to a number of reasons: the real difficulty in transforming production structures and developing new activities when the existing ones collapse; the persistence and power of economic elites and their ability to impose their interests and block alternatives; the persistence of the analytical approaches used by the most influential academic and professional economists; and the restrictions imposed from outside. Therefore, this is a recession that can be considered the result of neoliberal policies which in Spain gave rise to a spectacular financial-property bubble. Far from leading to a thorough review of these policies they are being reinforced. In the heat of the moment, under pressure from mass unemployment and budgetary problems, the policies adopted reinforce the power of these groups, weaken social and labour rights and put all trust for recovery in an ethereal restoration of confidence and competitiveness.

In this context, European policy does not seem to be mitigating the depth of the recession, either. Devaluation is not an option. For an

economy needing to bring about a change in production, it is not clear what measures can be implemented to carry this out without clashing with European competition policies. The European single market has been guided by countries with very different production structures geared towards exploiting economies of scale. This situation generates large regional inequalities, which are partly at the root of the current problems in various countries. The lack of a policy to make the regions more balanced, coupled with budgetary policy constraints, tends to make recovery more difficult. Only a policy of major public spending in the best-positioned countries is likely to be capable of sparking a recovery.

Furthermore, the advance of neoliberal policies is occurring in the absence of clearly designed alternative proposals. In our opinion, real reforms must include:

- A realistic plan for transforming the production structure and for reform of the skill formation system needed for this change, in order to improve the external equilibrium. This transformation also needs to confront the challenge of environmental sustainability.
- Reform of the tax system in order to fund the necessary welfare system and recovery policies. Reform must also introduce progressive treatment of earnings.
- Reform of labour institutions and company organisation in order to promote decent work in terms of pay, skills, cooperation, working time and so on. A new model must guarantee an adequate balance between working time and private life.
- Recovery of the financial sector in order to reduce the financialisation of the economy.

The absence of a credible project on this basis has allowed adjustment policies to be presented as the only realistic response. In fact, the current recession in the case of Spain also signifies the failure of the ‘third way’ policy that the Zapatero government partly attempted to apply until 2010: the application of a neoliberal policy counterbalanced by the expansion of public services compatible with low tax pressure. When this model collapsed due to the drastic fall in tax revenues (from 38.5 to 31.5 per cent

of GDP), the neoliberal adjustment remained as the only viable answer. Although some social movements and academic circles have presented alternative proposals for action in many areas, they do not have a common focus, unlike their opponent, nor do they fit into a European perspective.

In this context, the short- and medium-term prospects are grim. Potential for changes in production that would lead to a new growth engine to take the place of the building industry is not evident. Nor is there evidence of plans to this end on the part of economic decision-makers. The labour market reforms will lead to increased inequality and falling wages in a country in which they are already low. The public spending cuts are increasing unemployment and precariousness in new industries (especially for employees with a higher education), while slowing down activity and creating worse living conditions and support for families. 'Confidence building' and the need to relaunch the economy are also putting pressure on increasingly necessary environmental protection policies.

It is unclear how the new liberalisation drive will bring about economic recovery. It seems that Spain is on the verge of increasing inequality, expansion of the informal economy, deterioration of public services and sustained recession, closer to the experience of many Latin American societies affected by adjustment plans rather than the Central European model that it has spent years trying to emulate.

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Crisis corporatism and trade union revitalisation in Europe

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1. Introduction: the return of the state and of the trade unions?

In the European employment model, governments and trade unions have a key role to play. However, in terms of their ability to act, neither seems to be in a good position. There is a broad consensus in the literature that the pressure to change in the transition to deregulated financial market capitalism has forced both of them onto the defensive. This pressure for change is the result of both external and internal factors. Particularly important among these are the increasingly trans-national nature of economic and political relations ('globalisation'); structural changes in economic, technological and social contexts; and altered lifestyles and patterns of consumption among the population (Bosch, Rubery and Lehndorff 2007a and 2007b). Welfare states have lost their ability to act, and comprehensive re-structuring and de-structuring programmes have led to institutions and benefits being scaled back (cf. Pierson 2001). The trade unions, too, have had to relinquish negotiating and organisational power, as well as political influence. Declining membership and financial resources, degressive levels of organisation, the erosion of trade unions' secure place within firms, a decline in their redistributive power in the fields of company and wage policy and, not least, the erosion of their lobbying power, all bear witness to this (Brinkmann *et al.* 2008; Dörre 2010).

Nevertheless, in the crisis of global financial market capitalism, the state and the trade unions seem set for a political comeback. Many governments demonstrated an ability to act that it was thought they were no longer

1. I am grateful to Christoph Ehlscheid and Steffen Lehndorff for their valuable suggestions.

capable of showing. Comprehensive short-term economic programmes, far-reaching interventions in capitalist property rights and measures to restructure the financial sector were part of a new form of state interventionism practised by governments of all ideological persuasions (Hassel and Lütz 2010; Mayntz 2010). At the same time, social dialogue has gained fresh importance in the context of the state's response to the crisis (Glassner and Keune 2010a and 2010b; Hyman 2010). In a whole range of countries, reduction in working hours, wage restraint measures and more flexible contracts of employment have been agreed, and are supported by statutory arrangements and government compensation payments. As a result of these negotiated reactions to the crisis, the survival of firms – and hence jobs – has been secured. In the political arena, trade unions who were willing to cooperate have encountered equally cooperative government policies (Hyman and Gumbrell-McCormick 2010a). Trade unions were sometimes able to play an influential role in these social pacts. This was certainly the case in Germany, whose model of crisis policy will be central to the following discussion. German trade unions played a decisive part in the 'German labour market miracle' (Möller 2010), whereby jobs, firms and added value could be stabilised in the industrial sector, even though the slump in production and orders turned out to be particularly dramatic. These successes stimulated a debate in the media about a trade union renaissance, leading to fresh recognition among leading sections of society (Urban 2010a).

Based on a fairly new strand in international trade union research, and on observation of developments in Germany, it will be argued in what follows that corporatist arrangements, as they have emerged from the crisis of financial market capitalism – and which can be seen as elements of a national crisis corporatism, although associated with high costs – have nonetheless proved valuable for politically weakened trade unions. Doubts have, however, been expressed about the view that the new social pacts represent an appropriate institutional framework for future interest-driven policies and a sustainable organisational revitalisation of trade unions. From the unions' point of view, a strategy of autonomous revitalisation promises to be more successful, although it does presuppose a renewal of trade union resources and the strengthening of trade unions' negotiating and organising power.

This chapter is structured as follows. A brief sketch of the power resources approach in research on revitalisation in Section 2 is followed in Section 3 by a presentation of the German Social Pact and an attempt to formulate some generalisations about the new 'crisis corporatism' as a concept, and to incorporate the new regime of authoritarian stability in Europe into the discussion. The forward-looking review in Section 4 discusses conclusions to be drawn for efforts at trade union revitalisation, and ends by identifying some outstanding academic questions on research and trade union strategies.

2. Power resources and trade union revitalisation – the theoretical context

Trade union research in Germany has constantly spelt out the crisis-related dimensions of the trade unions' situation, but has devoted little scholarly attention to the options and preconditions for trade union recovery. Gradually, however, it is linking up with a more recent strand in international trade union research, known as the 'strategic unionism approach', which is slowly building into an area of research in its own right, entitled 'labour revitalisation studies' (Voss and Shareman 2000; Frege and Kelly 2004; Huzzard, Gregory and Scott 2004; Dörre 2008; Gall 2009; Haipeter and Dörre 2011). According to the premises of this approach trade unions, in financial market capitalism, find themselves in an open, non-determined situation. Rather it is the economic, social and politico-cultural contexts that shape an area of possibility with a diversified structure of opportunity. This offers the trade unions a range of strategic options and may produce differing results in terms of the intended revitalisation (Huzzard 2004). In other words, 'Hard times can often result in strategic paralysis, but can also be a stimulus for the framing of new objectives, levels of intervention and forms of action' (Hyman and Gumbrell-McCormick 2010b: 327). How successful they are in selecting strategic options, and how great is their capacity for innovative practices, depends on a realistic analysis of the operating context, adequate action strategies to deal with the problems, and sufficient power of self-assertion ('strategic choice').

Whether available options for action can be taken up is not least a question of power. Power can be understood as the capacity of individuals and organisations to realise class interests. A distinction is made here –

according to E.O. Wright (2000) – between the ‘structural power’ and the ‘associational power’ of organised labour. The former arises from the position of wage-earners on the labour market (‘labour market power’) and within the production process (‘production power’). Associational power, on the other hand, arises from the gathering of wage-earners into collective organisations, whereby trade unions can act as key players representing political interests. In the course of the debate, associational power has added a new dimension to the concept of trade union power (Dörre 2008). This is based on the position of trade unions within the institutional arrangements of the welfare state. It rests on the relationship of forces, in social terms, between the state, capital and labour, which can be stabilised in a way that transcends short-term cyclical variations. One can even envisage a fourth dimension: the communicative power of the unions as a form of trade union ‘soft power’. This consists in the ability to intervene successfully in areas of the public sphere that are pre-structured on a hegemonic basis. Communicative power evolves in the conflict over ‘leadership of opinion’ and the ability to engender recognition of one’s own interests within society (Urban 2010b).

3. Trade union advocacy and the crisis in European financial market capitalism

Trade unions have lost power across the board in the transition to deregulated financial market capitalism (Addison and Schnabel 2003; Brinkmann *et al.* 2008; Dörre 2010; Urban 2010b). Although developments have varied from one country to another, depending on the politico-economic and institutional contexts, trade unions as a whole entered the crisis in a weakened state.

3.1 A successful model and its costs – the German case

This was also the case in Germany. Nevertheless, the German variant of a negotiated response to the crisis is seen as a successful model. Its essence has been the involvement of trade unions in a government crisis strategy that was prepared to stabilise industrial employment and added value, but at the same time was directed towards relieving the financial burden on companies and largely avoided saddling the financial market players with the costs of the crisis. The government’s

initial offer to the unions caused confusion, because it was tabled by a conservative-led coalition. The 'Agenda 2010' policy of the previous Social Democrat-led government and its occasionally aggressive policy of confrontation with the trade unions appeared to confirm the thesis of a 'decoupling' of the unions from the Social Democrats (Piazza 2001) and the end of German corporatism (2009). But even before the elections to the Bundestag in 2009, it was clear that the Grand Coalition was touting for favours from the trade unions. A new form of *reverse lobbying* made its appearance. Whereas in conventional lobbying social organisations seek to maintain the interests of their client base by influencing government decisions, in reverse lobbying the intended influence flows mainly in the opposite direction. The initiative has come from the political parties, or from government representatives. This kind of strategy appealed in the first instance mainly to Social Democratic Party (SPD) and government representatives. They were unhappy about the termination of the privileged partnership between the Social Democrats and the unions, as disastrous opinion polls and election results proved. But under Angela Merkel as Federal Chancellor the 'social-democratisation' of the Christian Democrat party and its re-positioning towards the centre has obviously gone hand in hand with a return to the idea of corporatism. The result has been a new appreciation of the trade unions as a potential resource to support their own policy strategies and stabilise political majorities (the 'vote-seeker' function). Under pressure from the crisis, and the potential for conflict inherent in the corresponding crisis policy, reverse lobbying appealed across the political spectrum as the nucleus of a tripartite social pact.

It is by no means easy, from a trade union point of view, to draw up a 'balance sheet' of the German response to the crisis. On the plus side one may list, first, success in securing employment and enhanced public appreciation of the trade unions. Even among those who tend to be critical of corporatism, the union leadership and the policy they have adopted in the tripartite negotiating sessions have gained recognition. 'They have proved themselves as crisis managers, and in the political give-and-take they have achieved concessions (generous short-time working arrangements, scrappage premium) and results (securing core workforces) which in other countries could not be achieved even with militant protests' (Dörre 2011: 268). Obviously, the new, crisis-induced Social Pact has opened up channels of influence for the trade unions that they have been able to use in their own political interests (Urban

2010a). But a balance sheet without a 'liabilities' column tells us nothing. The price paid for successes in crisis policy must also be included. For example, securing employment through reductions in working time has been linked to a scaling-down of contract work and considerable concessions by core workforces on pay and on working and performance standards. Alongside relatively small nominal pay increases, tendencies towards extending the duration of agreements and delaying the starting-point of wage increases have been observed. Lump-sum and one-off payments have also become more widespread, damping down future wage increases (Bispinck 2011). At the same time, securing employment has been linked to a forced restructuring of firms, leading to widespread intensification of performance and health-related pressures on employees (Schröder and Urban 2011). In addition, this policy model has shown itself unsuited to realising certain essentials of the trade unions' strategy for overcoming the crisis. These include IG Metall's demand for a Public Equity Fund. This was to be funded by a levy on private capital and serve as an instrument for intervening, as part of crisis policy, in the system of ownership and for making the necessary structural changes (Urban 2009b). It could not be achieved.

Looking at the German Social Pact from the perspective of power resources makes it easier to understand why the unions had to pay a high price for securing employment, and why more far-reaching trade union demands were not achievable. Corporatist bargaining systems are based on the principle of political exchange (Hassel 2009: 9–10). In this process, successes as a rule cannot be obtained without making concessions. Thus the logic of bargaining acts as a filter on demands, sorting out those claims by a given corporate player which conflict too strongly with the interests of others. Which interests and demands prove achievable in the end depends in part on negotiating skills and the institutional rules of give-and-take, but also – and principally – on the bargaining power each party possesses. The German Social Pact follows this logic. Thus labour hoarding (for example, as a result of short-time working) and preserving industrial added value (for example, by means of the scrappage premium) were in the interests of both trade unions and employers' associations, and also of a government concerned about public approval ratings. They were therefore able to achieve consensus and be implemented, and formed the basis for 'discourse and decision-making coalitions' (Hegelich 2010) which helped these demands to succeed in the common interest. The demand for a Public Equity Fund

turned out quite differently. This did not lie within the area of overlapping political interests for all players; agreement among the parties was therefore not possible. The Public Equity Fund would have amounted to a structural, crisis-related intervention which changed the rules of economic life, and was considered indispensable by the trade unions and some sections of public opinion. But it obviously came too closely into conflict with the property and power-related interests of the capital-owning organisations and the regulatory assumptions of an economically liberal government. As a result, this proposal did not even make it onto the negotiating agenda.

3.2 A change in the German model of capitalism

For the trade unions, therefore, the German Social Pact was associated with notable defensive successes, but also with high costs and the blocking of more far-reaching demands. Whether a rejection of corporatism and a strategy of confrontation would have produced better results for the politically weakened unions is, however, doubtful, especially in light of developments in other countries (Hyman and Gumbrell-McCormick 2010a). But the demands placed on the unions, in Germany too, go beyond passively protecting their workers from the crisis. The change in the German model of capitalism was at the same time a period of considerable loss of redistributive function and of power for organised labour (Lehndorff 2009):

- Even before the shock of the crisis, many company employment pacts had turned out to be insufficiently resilient. They had been set up to deal with problems specific to the undertaking concerned, and hence to preserve competitiveness and employment. Generally, the employees made concessions on working time and pay, while the employers in turn gave assurances on employment and safeguarding particular locations. But the implementation of the mutual agreements was often asynchronous. The cost-reducing concessions made by the workforce were implemented immediately, whereas the employers' assurances – such as avoiding operational redundancies – could be cashed in only over a period of time. Empirical studies show that 'in a not inconsiderable proportion of these pacts, undertakings from the employers' side on job security were either not adhered to or only

partially adhered to. Given that the employees always have to make the first move in an employment pact, these findings suggest a degree of asymmetry in the agreements' (Bogedan, Brehmer and Seifert 2011: 59).

- Redistribution in government economic and social policy has also been asynchronous. The rise in statutory age limits for pension insurance ('retire at 67'), the end of parity-based funding in statutory health insurance and the tightening of the conditions for unemployment benefit (the 'Hartz reforms') illustrate this development. As a result, the financial burden in social insurance has shifted towards the insured, sometimes with a simultaneous deterioration in benefits. At the same time, upturns on the labour market have involved the replacement of socially protected full-time employment by often poorly secured working conditions in part-time work, short-term contracts or in the form of 'dependent self-employment'. The distribution of national income has also worked to the disadvantage of labour: since the beginning of the 1990s, net real wages in Germany have hardly increased at all; and the admittedly strong growth phase between 2004 and 2006, compared to the previous stagnation, was actually accompanied by a diminution in net real wages over a period of years. This was due, not to increased demands on wage incomes as a result of social costs – taxes and contributions – but to 'an extraordinarily weak rise in rates of pay, even by international standards' (Brenke 2009: 550). By contrast, the share of income of capital and company profits increased as part of the country's wealth (Schäfer 2010).

The redrafting of the labour market and social security 'architecture' and developments in redistribution policy signal a striking loss of power for the trade unions. The 'return of social uncertainty' (Castel and Dörre 2009) into the lives of wage-earners as a result of comprehensive deregulation of the labour market has moved to the centre of unions' negotiating and organisational power. To this was added the destabilisation of the industry-wide multi-employer wage agreement. This not only brought about a decline in the ratio between wages and national income, but at the same time reduced trade unions' capacity to regulate wages. Here again, the unions have lost a great deal of institutional power (Bispinck and Schulten 2009; Streeck 2009: 38–45). In conditions

of persistent unemployment, increased job insecurity and the government's policy of restructuring and dismantling the welfare state in response to the crisis, the trade unions have ended up in a downward spiral in terms of their redistributive function and power politics. This has been interrupted by phases of economic upturn, but not wholly arrested (Urban 2010b).

3.3 A new 'crisis corporatism'?

It is not only in Germany that negotiated responses to the crisis and fresh impetus towards moderation in wages and working time have emerged (cf. Hyman 2010; Glassner and Keune 2010a and 2010b). This reactivation of social partnerships and social pacts can be understood as a further stage in the metamorphosis of the conventional corporatism of the social democratic/Keynesian era (Schmitter and Grote 1997; Traxler 2004; for a critical view, see Hassel 2009: 13).

In recent research, particular attention has been paid to the significance of the power resources and interests of the state, trade unions and capital-owning organisations, on the basis of which the corporate players define their strategic preferences (Baccaro 2008; Hassel 2009). Macroeconomic framework conditions are highlighted as particularly significant here. An analytically useful distinction is drawn between 'policy interests' and 'power interests'. Both can be given differing strategic weight (Hassel 2009: 9–13). Whereas policy interests result in strategies which are geared to solving political problems or achieving political aims, power interests above all promote strategies to stabilise the political power of governments or the associational power of organisations. From the state's point of view, an interest in cooperation with the trade unions emerges if their involvement is likely to help solve major economic or social problems, or if the unions are able and willing to contribute towards gaining acceptance for government action or improving their electoral chances. A strategic interest for the trade unions in social pacts arises if the unions' capabilities are sufficient to mobilise against the government using the power of vetoes and blockades, but not for a confrontational assertion of claims for high wages, secure jobs and generous social transfers. This is also the case if having their members' interests represented in social pacts can help stabilise the organisation. At the same time, players' interests and

strategic preferences, and hence the stability and duration of cooperative pacts, can quickly change.

Empirical research on social pacts has identified country-specific differences in the formation of corporatist arrangements in the pre-crisis phase, but also common features. These common features were observed relatively independently of institutional contexts and political traditions. Describing these competitive corporatist pacts as 'coalitions of the weak and moderate' indicates the degree of empowerment and strategic calculations of the players (on this, see Baccaro and Lim 2006; Baccaro 2008). Weakened governments which, because of globalisation, the electoral system or over-powerful players with the power of veto, cannot tackle problems on their own, come up against trade unions which, because of a declining rate of union membership and general changes in the economy and in politics, have also lost bargaining power, but still retain a minimum mobilising capacity and hence a power of veto. The unions' readiness to participate in social pacts was often preceded by bitter internal struggles, in which the 'moderates' asserted themselves against the 'radicals' and took over the strategic direction of the organisation. The willingness of the capital-owning organisations to let them in has varied according to their expectations regarding the outcome of social pacts, and has occasionally proved important, not for their emergence, but for their stabilisation.

The crisis in financial market capitalism has generated a new macroeconomic context, which has affected players' interests and ability to act. This was true of the economy in the first instance because of the suddenness with which loss of full capacity and production occurred. But it also affected the state. The new government interventionism exhibited substantial differences from the era of the welfare state. Nationalisation, short-term economic policy and market correction measures took place under pressure of a massive financial and economic crisis, and were designed first and foremost to stabilise the domestic economy and financial base. At the same time, the objectives being pursued could be achieved only by intense cooperation among nation-states, which in turn limited the ability of individual states to act (Hassel and Lütz 2010). Finally, ad hoc interventions, which stabilised the economic situation and the financial system through comprehensive expenditure programmes and compensation for debt-related failures in the private sector, seriously overstretched

the financial capability of states. As a result of the crisis-induced 'largest peace-time growth in indebtedness' (Wagschal and Jäkel 2010) most of them did not just overshoot the debt targets of the European Growth and Stability Pact, but also at the same time slid into a debt regime which threatens to undermine governments' ability to act in future.

These features in themselves suggest that the cooperative crisis policy of the state is not just a re-run of the competitive corporatist policy of the pre-crisis phase. To describe the arrangement which has emerged from this new constellation, we suggest the term 'crisis corporatism' (*Krisen-Korporatismus*). In Germany, the new corporatism follows the tradition of corporatist arrangements, but at the same time differs from previous stages of development (see Table 1). The 'social corporatism' of Fordist capitalism evolved on the basis of players of relatively equal strength orientating themselves, in situations of conflict and cooperation, towards the negotiation of a symmetrical class compromise, in which essentially the interests of all players were reflected. The state functioned as a market-correcting welfare state, and the trade unions as the redistributive agents of wage-earners. The redistribution of income flows produced by the market was widely seen as a necessary requirement for solidarity. The subsequent 'competitive corporatism' developed during a phase when the Fordist/welfare state model of capitalism had come under pressure for change, both internally and externally. Transnationalisation of the economy widened companies' strategies to include the relocation option, and strengthened their bargaining power in relation to government and trade unions. The redistributive interests of wage-earners were subordinated to the competitive interests of firms. The State, which had also become weaker compared to business, shifted its activity from a demand-orientated policy of redistribution to one based on competition and supply (the 'competitive state'). Within undertakings, increasing companies' competitiveness took priority over company redistribution policies, meaning that the redistributive interests of the workforce were served only within the framework of additional competitive gains. The representatives of company and trade union interests also slotted into this new 'competitive solidarity' (Streeck 2000), and duly made their contribution towards ensuring that firms survived in the face of fiercer international competition.

Table 1 Varieties of corporatism

	Social corporatism	Competitive corporatism	Crisis corporatism
Period in financial capitalism	Preliminary phase	Development phase	Crisis phase
Degree of empowerment of players' groupings	Alliance of the strong: Trade unions: strong; Capital: strong; State: strong.	Asymmetrical alliance: Trade unions: weakened; state: weakened; Capital: strong.	Alliance of the weak: Champion: financial capital; trade unions: weak; state: weakened; real capital: weakened.
Distribution regime	Symmetrical (class-based) redistributive compromise between labour/capital/state	Tendency to asymmetrical distribution in favour of capital at the expense of labour and state	Structurally asymmetrical distribution in favour of financial capital at the expense of labour/state/real capital
Guiding principle	Redistributive solidarity	Competitive solidarity	Social pacts as acute emergency coalitions
Type of state	Welfare state	Competitive state	Crisis state
Trade union type	Redistributive player	Competitive partner	Crisis moderator

Source: Author's presentation.

The tripartite alliance that developed in Germany as a result of the crisis shows significant differences from social corporatism and from competitive corporatism. These make it plausible to talk about a new, crisis-induced corporatism. First, the acute crisis in financial market capitalism represents a specific macroeconomic context, fundamentally different from that of the prosperity phase, which changes the interest base and power resources of the corporate players. Under pressure of the shock crisis, government, unions and companies in the real economy ended up on the defensive against financial market mechanisms and the lobbying power of their key players. Crisis corporatism represents an *alliance of the weak*; social pacts at company and political level are seen as acute emergency coalitions formed in response to the crisis. This has impacted on the results of the policy. Admittedly the employment interests of core workforces were relatively successfully preserved during the acute phase of the crisis. But acceptance of the running-down of marginal workforces (especially contract workers), the concessions made on pay rates, working time and working conditions for core workforces, and the absence of any participation by financial market players in the costs of the crisis make it clear that the redistributive interests of wage-earners remain largely subordinate in this alliance.

Admittedly, the wage figure across the economy as a whole, and hence the relative redistributive position of dependent labour, rose briefly – as usual – during the peak phase of the crisis. But this development reflects, not a power gain for the trade unions, but the rapid downturn in profits in the real economy brought about by the crisis. Even though the development was reversed as early as 2010, companies in the real economy are not the main beneficiaries – unlike under competitive corporatist arrangements. Rather the dominant crisis policy was accompanied by a transfer of added value from the real to the financial economy, which found expression in the collapse of industrial profits and the spectacular rise in public debt. Government policy was geared, not towards the goal of sustainable improvement in the conditions of competition, but towards ad hoc stabilisation of firms, and as far as possible avoided any regulation of the financial economy. The unions and works councils acted as moderators in the acute struggle of firms to survive, and were seen by those involved, and by the public, as emergency coalitions in an exaggerated crisis situation.

3.4 The regime of authoritarian stability in Europe

This brief sketch of the tripartite response to the crisis in Germany cannot – and is not intended to – be more than a first approach from the perspective of corporatism theory. The nature of the social pacts that have been developed in response to the crisis – and not only in Germany – has yet to be fathomed, either empirically or theoretically. The low value placed on similar crisis-driven developments at European level is, however, striking in view of the recent debate in Germany. It is true that in integration research, European unification is generally treated as a multi-layered process, in which developments at regional, national and European level are seen as interdependent elements in an overall process (cf. Jachtenfuchs and Kohler-Koch 2003). But this multi-layered perspective has not, so far, found its way sufficiently into German research on corporatism. This ‘Europe gap’ is proving problematic because fundamental decisions are being made at European level that might have decisive implications for policy in the member states.

By the end of 2010, almost all Eurozone countries were overshooting the stability targets of the European Economic and Monetary System (ECB 2011). Step by step, through a non-transparent process of negotiation,

moulded by national interests, a new regulatory framework for economic and financial policy was crafted. It is based on existing agreements on European governance, and enhanced coordination of economic policy, which in the wake of the revised Lisbon Strategy were summarised under the heading 'Europe 2020'. The architecture of the new regime is supported by two institutional pillars: the first consists of a regulatory framework for tighter control of economic policy and budgetary oversight in the Euro area. This provides, in particular, measures to strengthen the competitive position of economically weak member states, and sanctions for those whose budgetary policies are in deficit. The second pillar is a permanent crisis management mechanism, the European Stability Mechanism (ESM). This is to be activated whenever the over-indebtedness of one member state threatens the financial stability of the Eurozone as a whole and ties the granting of financial assistance in the form of loans to strict constraints (Urban 2011).

This new institutional regime directly affects areas of policy and regulation that were previously the preserve of member states and the parties to collective agreements. This happens, first, through restricting the fiscal margin for manoeuvre of national policies. Here the trend is towards technocratic prescription, as was already inherent in the Stability and Growth Pact (SGP) within the Economic and Monetary Union (EMU) (avoiding excessive deficits of more than 3 per cent or a public debt figure over 60 per cent of GDP). In the new regime, this latent authoritarianism takes on a new quality. Taken as a whole, the new institutional arrangement can be understood as a regime of authoritarian stability, which is likely to prove economically counter-productive, socially polarising and a threat to political legitimacy. What is intended as a programme to stabilise the EU and its currency could turn out to be a programme that aggravates economic and social problems, and ends in a state of precarious stability (Urban 2011). By fulfilling the obligations attached to the provision of credit, the well-known vicious circle of a pro-cyclical finance policy is set in motion, leading to loss of demand and absence of growth. This loss of growth also makes it difficult to produce the resources needed to re-finance debts. As a result, the creditworthiness of the debtor goes down, which immediately leads to a lower credit rating from the leading agencies. This in turn drives up risk premiums and interest rates for capital market loans, and hence the costs of obtaining fresh credit.

This new *authoritarian regime of precarious stabilisation* is linked to a whole range of violations of wage-earners' interests, and to a drastic deterioration in the conditions under which trade unions operate. The rules for the development of wages, productivity and social systems interfere deeply in the mechanisms of capital/labour/state relations at national level, and subordinate national economic policies and the whole labour and social security architecture of member states to an overblown policy of competition and stability. Alarm bells should be ringing for trade unions. To drive down debt deficits, governments will cut drastically into systems of social protection and reduce benefits. However, reduced compensation for risks, especially unemployment and inability to work, increases the pressure on wage-earners and intensifies the 'reserve army mechanism' on the labour market. This in turn weakens the bargaining power of the unions. At the same time, fiscal restrictions will lead to a loss of function for governments as active economic players responsible for economic, employment and industrial policy, and hence for stabilisation of growth and employment, not to mention to an inability to fulfil governmental responsibilities in relation to eco-social structural change. Possible impulses for growth and employment are being thrown away. Even the social partners' current role in moderating wage negotiations will not remain unscathed. Lip-service paid to maintaining the autonomy of social partners in collective bargaining will be pointless in the face of economic 'disciplining' and downsizing. A massive restriction of autonomous national collective bargaining systems is likely to be the consequence.

Trade unions in EU member states seem poorly prepared to face these risks. So far, their policy has been aimed primarily at fending off threats to the interests of their core memberships, and has remained stuck in the domain of national economic and social policy. Attempts to influence government policy on Europe, and hence crisis policy at European level, have remained just as underdeveloped as efforts to coordinate, or indeed network, redistribution campaigns across national borders.

4. Looking ahead

Summing up, we can say that, despite some signs of a revitalisation of trade unions, the crisis so far has not represented a positive 'turning point for labour' (Baccaro 2010). The unions have not benefited at all

from the political and ideological humiliation of neoliberalism. Analysis of union activity during the crisis has shown 'that the unions are in dire straits, and that (...) the global financial crisis has done nothing to improve their plight and has possibly worsened it. (...) Instead, the declining trend is visible everywhere: in New Zealand and in Austria, in Germany and in the UK' (Baccaro 2010: 347). Evidently the process of erosion of trade union power was too all-embracing for the unions to be able, under the more difficult conditions of the crisis, to intervene strategically in the sense of proactively influencing the dominant crisis strategies (Boyer 2010, Crouch 2010).

4.1 Trade union revitalisation

What conclusions might be drawn from this for the debate on trade union strategy? The set of problems outlined shows that correcting the asymmetrical distribution of incomes and power before and during the crisis, and the Europeanisation of trade union policy to defend their members' interests should be a high priority on the union agenda. To this must be added efforts at revitalisation in terms of power politics, since success in terms of redistributive and European policy requires a considerable degree of bargaining and associational power. In light of these requirements, it appears questionable whether the social pacts of crisis corporatism offer an appropriate institutional framework for fulfilling them. An aggressive redistribution policy in favour of wage labour, re-regulation of the labour market and achieving an egalitarian distribution of incomes and capital would quickly prove incompatible with corporatism because it conflicts too strongly with the interests and power claims of other players. At the same time, one cannot dismiss the danger that the continued presence of trade unions in national social pacts might hamper the overdue transnationalisation of union policy. If the crisis-induced corporatist alliances were to continue after the acute phase of the crisis in the form of renewed local pacts under the terms of competitive corporatism, this would tie up the very union resources that are essential for a strategic Europeanisation of trade union policy.

It is difficult to determine just where the limits of corporatist, interest-driven policy lie. Research on the opportunities and restrictions of crisis corporatism is still lacking. An alternative strategy involving an autonomous, confrontational stance would be preferable, from a union

point of view, (only) if the redistributive and organisational successes that could thereby be achieved exceeded the interest-based concessions which could be achieved in the political trade-off under crisis-induced corporatist arrangements. Interest-driven successes for trade unions in capitalist societies are not just a question of strategic will, but also of what is doable in terms of power politics, and hence dependent on the possession of sufficient power resources. This applies as much to strategies geared towards conflict and militancy as it does to those geared to compromise and dialogue. In this way, the regeneration of trade union power in financial market capitalism becomes a general condition for successful interest-driven policy, irrespective of whether 'boxing or dancing' provides the appropriate metaphor (Huzzard, Gregory and Scott 2004).

Strategic efforts must be developed and implemented in line with the national variants of the European employment model and the relevant production, employment and welfare regimes (Bosch, Rubery and Lehndorff 2007a). In the circumstances of the German model the following aims have been mentioned as particularly important: first, broadening the operational base within firms, and making work less insecure; second, raising the general level of trade union membership and organising new groups of wage-earners; third, institutional reform of the industry-wide multi-employer wage agreement and the labour rules and social structure; fourth, extending influence in the national spheres of economic and social policy; fifth and last, the communicative strengthening of trade unions' crisis policy and its underlying ideas (Urban 2005).

But whatever the institutional specifics of each national regime, it is the unions' strategic understanding of their role that is likely to determine whether the strategic challenges are recognised and tackled as such. As a structurally conservative blocking power – defending what can be defended both during and after the crisis – they are unlikely to succeed. Even sticking to their role as the companion of modernisation and moderator of the crisis is likely to fall short of what is required. Much more promising is a political understanding by trade unions of their role as a *constructive veto-player* (Urban 2005). This self-understanding assumes that not only the transition from the Fordist formation to a new socio-economic model of development, but also the emergence of this model from the crisis, involves power-based conflicts over redistri-

bution and negotiation; and that in this the ability to mobilise power resources adequately will be the precondition for being able to assert themselves as participants in areas of conflict. The same is true of defensive conflicts against inadequate problem-solving strategies and (partial) successes achieved within a strategy of gradually overcoming the defensive position of the unions. At the same time, the corresponding power of veto is used 'constructively' in the sense that it is not aimed at preserving status quo structures, but at making its own contribution to reconstructing the socio-economic model of development. Mobilising the power of veto to prevent crisis management strategies that would exacerbate problems is set alongside mobilising the power of change to assert problem-solving political concepts.

4.2 Outstanding issues in research and strategy

Assessing the crisis from both an academic and a trade union point of view provides considerable scope for sociological research and trade union strategy debate. First, it is important to continue scholarly work on the concept of corporatism and develop a terminology which expresses the specifics of the macroeconomic context, and the interests and degree of empowerment of the players. This raises the concept of 'crisis corporatism' as a theme for discussion. These efforts should above all seek to connect with the current debate on national states' new ability to act. If scepticism were to harden towards the proposition of a return to governments which are comprehensively capable of acting during the crisis, this would inevitably have an effect on the reliability of government assurances and the chances of success of crisis-induced corporatist alliances.

At the same time, it would be desirable to investigate the far from trivial implications of trade unions' corporatist involvement for decision-making within organisations. Even crisis corporatism is caught between a politically-orientated logic to exert influence and a countervailing logic to assert members' interests (Streeck 1999: 223–245). For this reason, too long and intensive an involvement in social pacts that distribute the profits and costs of the crisis in a flagrantly unequal way could pose a risk for the unions' internal democratic structures. In other words, the more trade unions become involved in corporatist arrangements, and the higher the price to be paid in terms of interest-

driven policies, the stronger the tendency could become among union leaderships to exert influence on internal discussion and decision-making processes in order to minimise the conflicts between the results of internal opinion-forming and the requirements of corporatist alliances, and to maximise the ability of trade unions to commit themselves. Such internally-generated measures can rapidly lead to restrictions on any authentic articulation of members' interests and hence damage the democratic process within organisations (for a stimulating contribution on this, see Molina 2008). Whether these risks for democracy can be countered with decentralised decision-making structures and more members' participation, or whether these measures lead rather to the blockage of the tripartite political model, should be questions for practice-based policy research.

Not only trade union research, but also the unions' own debate on strategy are under challenge. The findings presented here argue for a twofold differentiation of trade union efforts at strategy. So far, attempts at trade union revitalisation have been geared, more sporadically than systematically, towards redistribution and power conflicts in the national sphere. But this narrowing of strategy fails to do justice to the complex of problems in a Europe dominated by financial market capitalism. Instead, the multi-level perspective must find its way into the trade unions' debates on strategy. This requires a re-orientation of European policy on a paradigmatic scale (Urban 2009b). This Europeanisation of trade union policy should be linked to a second strategic challenge. There is talk of broadening unions' interest-driven policy in the direction of alliance-based policies. The starting-point could be a Europe-wide movement, a heterogeneous collective player, consisting of different initiatives, organisations and personalities, for which the term 'mosaic left' has been brought into play (Urban 2009a and 2011). Such a transnational left, however, would first have to evolve. This might happen in a Europe-wide, pro-European social resistance movement against the regime of authoritarian stability and in favour of a cooperative and democratic Europe. The strategic gain for the unions could lie in supplementing their own insufficient power resources by alliances with other powerful movements (Hyman and Gumbrell-McCormick 2010b: 328).

Let there be no doubt: the revitalisation of the trade unions in terms of power politics is first and foremost a project which demands efforts within organisations. But there is a lot to be said for putting these

efforts in a more all-embracing, Europe-wide and alliance-based context. To ignore this challenge would merely be to prolong the defensive stance of the trade unions.

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How do economic governance reforms and austerity measures affect inclusive growth as formulated in the Europe 2020 Strategy?

Janine Leschke, Sotiria Theodoropoulou and Andrew Watt

1. Introduction

The financial crisis that broke out in 2008 has turned into an economic and public debt crisis that has been sweeping the EU with a severe impact on the economies and labour markets of member states. Output growth has turned negative in several countries and stagnated elsewhere; unemployment has risen; and public debt and deficits have soared. Partly in response to the crisis and partly within the framework of a longer-term growth and reform agenda, the EU spelled out the Europe 2020 Strategy in 2010, which for the first time puts inclusive growth on an equal footing with smart and sustainable growth – at least on paper. To that end, a headline target of moving 20 million people out of poverty by 2020 has been set. The strategy calls for structural reforms in several areas, as well as for steering the public finances of member states onto a sustainable path as soon as possible.

Moreover, in response to the debt crisis that has been threatening the very existence of the Eurozone and as a complement to the Europe 2020 Strategy, the architecture of the EU's economic governance has come under scrutiny with the aim of introducing reforms that would strengthen it against similar crises in the future. At the same time, the Eurozone member states have been trying to contain the public debt crisis which, at the time of writing (September 2011), has spread to five member states and has become a systemic threat to banking systems in the EU.

National policies in the context of the Europe 2020 Strategy and the new economic governance are to be streamlined and coordinated within what is now called the 'European Semester', which is essentially the annual policymaking cycle in the EU. However, both the economic governance reforms and the austerity measures pursued as a response

to the debt crisis have attracted criticism for their potential to push the European economy into a double-dip recession and strangle growth for several years to come. This would then undermine the objectives of the Europe 2020 Strategy, including that of inclusive growth.

This chapter analyses whether the recent EU economic governance reforms and the austerity measures are likely to affect the prospects of achieving the headline target of lifting 20 million people out of poverty. Fiscal austerity, as planned in several member states, is bound to critically delay output and employment recovery, leading to prolonged and structural unemployment which is associated with detachment from the labour market. According to the Europe 2020 Strategy, the means of achieving inclusive growth are increasing employment, improving skills and fighting poverty. In this chapter, we focus on poverty because employment creation and improved skills actually failed to deliver in terms of reducing poverty in the context of the Lisbon Strategy (Cantillon, 2011). Moreover, in the face of the ongoing creation of substandard employment, with its danger of keeping people in low-wage employment, the development of poverty figures tell us more about inclusion than the mere monitoring of employment rates or developments in skills.

The chapter is structured as follows. In Section 2, we provide an empirical picture of the impact of the crisis on labour market outcomes and public finances in order to get a sense of the problem load and put into context the macroeconomic policy directions that the new economic governance and initiatives to resolve the crisis propose. In Section 3, we present the policy responses to the crisis and critically evaluate their potential to deliver growth. In Section 4, we analyse the Commission recommendations to member states in the context of the European Semester, the medium-term policy plans of member states in terms of – in particular – social spending and the measures already taken as part of the fiscal austerity packages in several member states in order to assess whether fiscal measures undermine and/or override measures for reducing poverty. Section 5 concludes. To support our arguments, we draw on comparative data sources, such as the European Labour Force Survey and national accounts, official EU level and national policy documents and evidence from national experts on austerity programmes (Matsaganis and Leventi, 2011; Theodoropoulou and Watt, 2011).

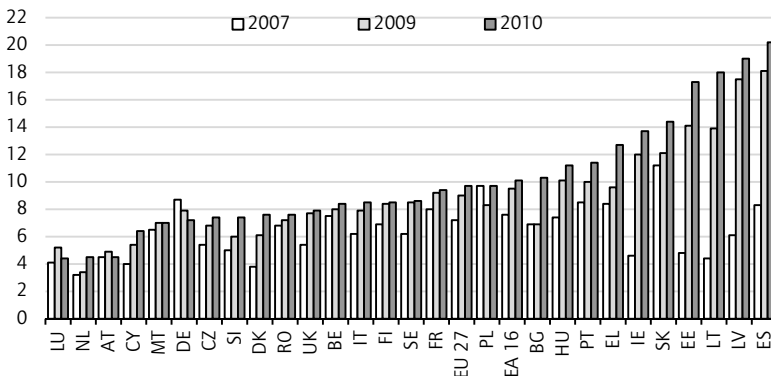
2. The economic crisis in Europe

In this section, we provide an empirical view of the impact of the crisis in Europe with regard to output, employment and unemployment. We also review the evolution of European governments' public debt and their budget balances. All these are crucial parameters for assessing the economic governance reforms and the fiscal austerity measures in terms of their potential to help tackle the current economic crisis and support the Europe 2020 Strategy in delivering its poverty headline target.

2.1 Bleak labour market developments

The EU27 average unemployment stood at 9.7 per cent in 2010, 2.5 percentage points up from 2007 (Figure 1). Employment dropped in the same period on average by 1.3 percentage points. The labour market impact of the large output shocks – average output in the EU dropped by 4.3 per cent in 2009 – was thus considerable. At the same time, as Figure 1 illustrates, there is significant variation in developments in unemployment (and employment) rates in Europe. Particularly Spain, the Baltic countries and Ireland saw huge increases in unemployment and large drops in employment and were among the countries with the highest unemployment rates in 2010 (for details, refer to ETUI/ETUC, 2011).

Figure 1 Developments in unemployment rates, 2007, 2009, 2010



Note: Unemployment rates for population aged 15–64 years.
Source: Eurostat online data base (labour force survey).

The spread has tended to widen these differentials. In the Baltics and Ireland, this was coupled with considerably larger than average drops in output (18 per cent in Latvia, 14.7 per cent in Lithuania, 13.9 per cent in Estonia and 7.6 per cent in Ireland). With 3.7 per cent, however, Spain saw below average drops in output which points to the absence of such things as working time measures, active labour market policies or early retirement and other exit schemes that can act as buffers. The working of such buffers is particularly evident in the case of Germany, one of the few countries that saw unemployment dropping despite a fall in output of 4.7 per cent between 2008 and 2009 (for details on the operation of buffers in the crisis see (Leschke and Watt, 2010).

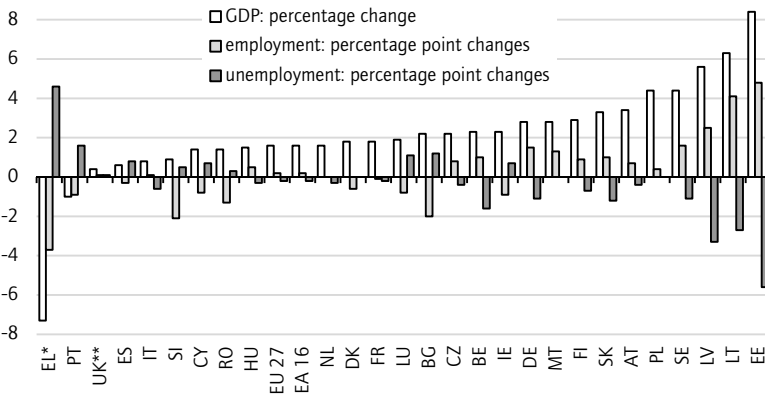
In the second crisis period (2010 compared to 2009) output was on average growing again (1.8 per cent for the EU27 – exceptions were Greece, Romania, Ireland, Latvia and Spain) but employment was still declining and unemployment still rising in the majority of countries. Figure 2 presents the most recent developments in terms of output, employment and unemployment (second quarter of 2011 compared to second quarter of 2010). Output¹ is still declining in Greece and Portugal, whereas some countries are showing major output growth, notably Estonia, Lithuania, Latvia, Sweden and Poland, with output growth surpassing 4 per cent. In line with the large output shock Greece saw employment declining by close to 4 percentage points and unemployment increasing by more than 4 percentage points. Employment in Slovenia and Bulgaria decreased further by around 2 percentage points, despite GDP growth. Portugal, Luxembourg and Bulgaria saw unemployment increasing by more than 1 percentage point. Looking at the five countries that initially experienced the biggest labour market impact of the crisis we see Spain and Ireland still doing relatively badly with output, in the former, growing only at a slow rate and employment still declining and unemployment increasing. This contrasts strongly with the Baltic countries where we see major output growth in the most recent period (following the massive contraction there) and strong

1. It should be noted that, given the ongoing debt crisis, these figures are subject to considerable uncertainty. In several cases of member states that have been receiving financial support from the EU/IMF and of those whose governments have been facing difficulties in the financial markets, their austerity programmes include adjustments being pursued as a condition of financial support and/or in an attempt to avoid having to request financial support. As the experience of Greece, Ireland, Portugal and Latvia has shown so far, such adjustments result in deeper recession than originally forecasted.

increases in employment. Unemployment was also declining strongly in the latter three countries, particularly in Estonia.

Two points are worth noting here. First, the Baltic States were among those countries that recorded very high employment losses/unemployment increases in the wake of the crisis. Therefore, these forecasted improvements would be occurring in labour markets that had deteriorated sharply. Second, at least in the case of Latvia, there is still a lot of uncertainty about the evolution of macroeconomic variables, such as GDP growth (Theodoropoulou and Watt, 2011).

Figure 2 GDP,² employment and unemployment rates, second quarter of 2011 (change compared to second quarter of 2010)



Notes: Employment and unemployment rates for population aged 15–64 years.

* GDP value is provisional. ** GDP refers to first quarter of 2011.

Source: Eurostat online data base (national accounts and labour force survey).

Not all labour market groups were equally affected by labour market developments. Young people (15–24 years) and the low qualified in particular saw their unemployment rates increasing during the crisis. Youth unemployment is now above 20 per cent and is thus more than double the unemployment rate of prime age and older workers, and it has reached 40 per cent in countries such as Spain and Greece. One

2. GDP as used in figure 2 refers to gross domestic product at market prices.

explanation why young people and the low skilled are particularly affected by increasing unemployment and declining unemployment is their disproportionate share of fixed-term and temporary agency work, with temporary workers being the first to lose their jobs during the crisis (for detailed information, see Leschke, forthcoming).

All in all, the picture that emerges from output and labour market developments in the EU from the beginning of the economic crisis until today is a bleak one. The end of the initial downturn did not do much to reverse the initial employment losses. Moreover, over the summer of 2011 signs of a renewed slowdown emerged, alongside evidence of deep-seated problems in the financial sector, against the background of the unresolved sovereign debt crisis. At the time of writing (end of September 2011), a double-dip recession and possibly even a decline into a second major crisis cannot be ruled out. And even optimistic forecasts are for no more than sluggish output growth, insufficient to substantially improve the labour market situation across Europe (although the picture may be brighter in individual countries).

The concern is that there are negative feedback loops between the state of the labour market, the vulnerability of financial institutions and the sovereign debt crisis. In the short term, uncertainty over growth and employment restrains bank lending and firms' recruitment. This also makes it more difficult to consolidate public finances, which creates further uncertainty. On the labour market the concern is that lower employment and higher unemployment rates will become entrenched, as happened for instance in the mid-1990s³. If the appropriate macro-economic demand-side measures are not or cannot be deployed, the use of market-oriented structural policies increases the risks of poverty and social exclusion. We return to this issue in more detail below.

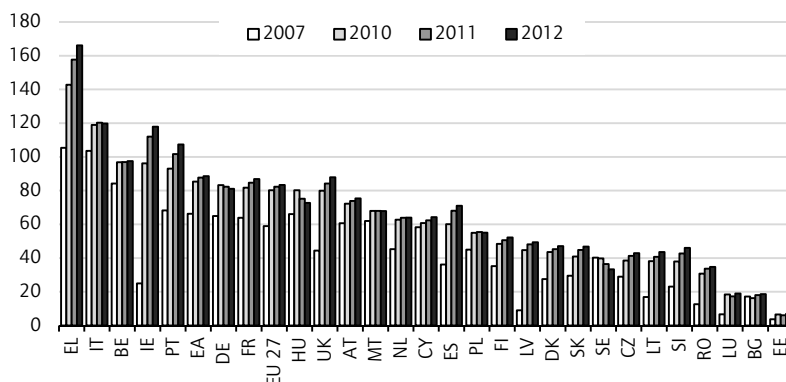
2.2 The crisis and the state of public finances

The economic crisis which began in the last quarter of 2008 has had substantial and varied effects on public finances in European countries

3. See <http://www.social-europe.eu/2011/08/rising-unemployment-please-not-199596-all-over-again/>

(Figures 3 and 4). On average, the gross public debt to GDP ratio in the EU27 rose from 59 per cent in 2007 (66 per cent in the Euro area) to 80 per cent in 2010 (85 per cent in the Euro area), while it is expected to rise further to 83 per cent by 2012 (89 per cent in the Euro area).⁴ Several EU member states saw their public debt to GDP ratios rise to levels that wiped out the fiscal consolidation of the past 25 years or more. Most notably, the debt to GDP ratio of the Irish government rose by 71 percentage points from 25 to 96 per cent between 2007 and 2010 and it is expected to reach 118 per cent of Irish GDP in 2012. Greece, Latvia and the United Kingdom saw rises in their gross debt to GDP ratios of 36–37 percentage points, with the Greek ratio climbing from 105 to 143 per cent between 2007 and 2010 and expected to go up further to 166 per cent of GDP by 2012. In the United Kingdom, the ratio increased from 44 to 80 per cent during the same period and is forecast to reach 88 per cent by 2012. Portugal, Spain and Lithuania also suffered debt to GDP increases of 21 to 25 percentage points between 2007 and 2010, although it is only the Portuguese ratio that has exceeded 100 per cent of GDP, with those of Spain and Lithuania being well below the EU/Euro area averages.

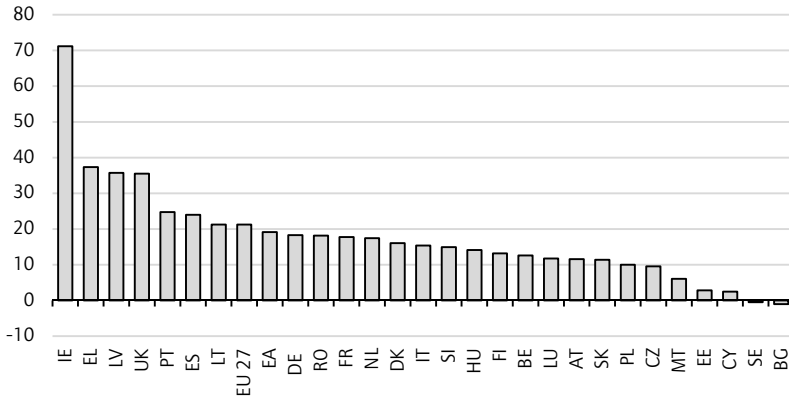
Figure 3 Gross public debt to GDP ratio, EU, 2007, 2010–2012



Source: AMECO data.

4. All figures and forecasts from the AMECO database.

Figure 4 Change in debt/GDP ratio, 2007–2010 (percentage points)



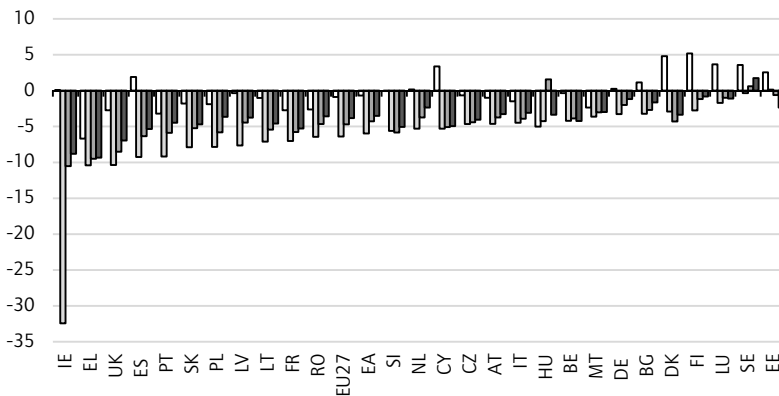
Source: AMECO data.

The increases in the gross debt to GDP ratio reflect two factors: first, the deterioration of government budget balances across Europe due to the crisis, reflecting the operation of the automatic stabilisers (Watt, forthcoming), the discretionary stimulus packages (Watt, 2009) and the measures to bail out the financial sector; second, the contraction of GDP. The average budget deficit rose from 0.9 per cent of GDP in 2007 (0.7 per cent in the Euro area) to 6.4 per cent in 2010 (6 per cent in the Euro area) (Figure 5). Although these average figures conceal a wide variation, only a handful of member states (namely the Nordic countries, Estonia and Luxembourg) still complied with the 3 per cent deficit limit of the Stability and Growth Pact in 2010.

As the credit crunch/financial crisis of 2007–2008 turned into a real-economy crisis, and doubts about the capacity of Greece to pay back its debt arose in the markets, the failure of European leaders to provide a credible and timely guarantee that a member of the Eurozone would not (partly) default on its debt and the refusal of the ECB to undertake the role of lender of last resort for governments sparked contagion and a debt crisis (DeGrauwe, 2011a). It is true that the Greek debt to GDP ratio was relatively high in 2009; however, its sustainability depends not only on this ratio but also on future government balances, the growth rate of the economy and the interest payments the government has to incur in order to keep rolling over its debt. The lack of guarantee

meant that the interest rate required from the Greek government to keep on rolling over its debt started increasing, turning what could have been a liquidity problem into a solvency problem (DeGrauwe, 2011b). This lack of confidence then spread to other Eurozone members with either high debt to GDP ratios or fast increasing government budget deficits. By early 2011, Ireland and Portugal had also sought financial support from the EU and the IMF in order to keep rolling over their public debt, while in the summer of 2011, Spain and Italy also faced very high yield spreads for their government bonds compared to German ones.

Figure 5 General government budget deficit, EU, 2007, 2010–2012 (% of GDP)



Source: AMECO data.

Because of the failure to provide adequate solutions, the Greek, Irish and Portuguese debts continued to rise, because under the financial ‘support’ programmes their governments have been effectively loaded with more debt, carrying relatively high interest rates (which were lowered following the European Council meeting of July 2011). At the same time, the severe austerity programmes that were imposed as a condition for receiving aid plunged the three economies into major recession which worked counter to fiscal consolidation by reducing public revenues, raising benefit expenditure and making spending cuts politically all the more difficult.

Summing up, we can see profound effects on European labour markets and government budgets from the crisis with, at the same time, great

variation between countries. Against this background we now turn to consider the policies implemented in Europe to the extent that they are driven by European policymaking initiatives and processes. First, we describe the main policy initiatives taken at European level since the crisis, before analysing how they have affected – and will continue to affect – national policy choices and also policy outcomes.

3. Policy responses to the quest for growth and the economic crisis: the Europe 2020 Strategy and economic governance reforms

3.1 Europe 2020 Strategy

Partly in response to the crisis, but partly within the framework of a longer-term reform agenda, the European Union has embarked on a complex, multi-layered process of changing the framework within which not only economic but also a wide range of employment-related, social and other policies are designed and implemented by both member states and the European institutions. This process is ongoing. This section summarises some of the key developments, focusing on those particularly relevant for the issue of inclusive growth and the headline target with regard to poverty.

The Europe 2020 Strategy is successor to the Lisbon Strategy, launched in 2000, which formally ended in 2010. Lisbon formulated the strategic goal of becoming ‘the most competitive and dynamic knowledge-based economy in the world, capable of sustainable growth with more and better jobs and greater social cohesion’; this goal was underpinned by a number of EU-level targets. The Europe 2020 priorities and strategy closely resemble those of Lisbon despite the fact that the European Union was not able to deliver on the targets (European Commission, 2010a) and probably would not have done so even in the absence of the economic crisis (for a critical account, see Pochet, 2010).

The Europe 2020 Strategy puts forward three ‘mutually reinforcing’ growth paradigms: smart growth through knowledge and innovation; sustainable growth entailing resource efficiency and a greener and more competitive economy; and inclusive growth, focusing on high employment

and social and territorial cohesion (European Commission, 2010c). Thus, even the social and environmental issues are framed in terms of the growth paradigm. Five headline targets for 2020, covering employment, R&D, climate/energy, education and poverty for the EU as a whole, reflect this strategy.⁵ The Council's 10 integrated guidelines for the implementation of the Strategy (six focussing on economic policies, three on employment and one on social inclusion and poverty reduction) are supposed to steer and guide reforms in the member states, whereby they are supposed to conform to the fiscal rules of the Stability and Growth Pact (European Commission, 2010d). The so-called seven flagship initiatives spell out the policy measures to be undertaken jointly by EU-level and national actors, which concern the policy areas regarded as most important.

In response to the economic crisis that has revealed the interdependencies and spillovers between different areas the Europe 2020 Strategy seeks to align macroeconomic policy developments and structural reforms within the framework of the so-called 'European semester'. Stability and Convergence Programmes (which focus on fiscal issues) and National Reform Programmes (which cover a wide range of structural policies) are now to be prepared at the same time in the first half of each year in order to ensure more coherence in reporting, evaluation and recommendations on thematic as well as on economic and budgetary issues, which can then be fed into the finalisation of national budgets (ex ante policy coordination).⁶ The aim is to strengthen budgetary discipline and promote macroeconomic stability and growth in line with the Europe 2020 aims.

As our chapter focuses on 'inclusive growth' and, more specifically, the poverty headline target we will look in more detail at this paradigm and its components. The first important thing to note is that, in the social

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5. The targets are as follows: an employment rate of 75 per cent for people aged 20-64; 3 per cent of EU GDP invested in R&D; a longer list of climate/energy targets; reducing the proportion of early school leavers to below 10 per cent and at the same time increasing the share of young people with tertiary education to at least 40 per cent; and reducing the number of people at risk of poverty in the EU by at least 20 million.
 6. This is a further step towards aligning various policy fields. The process started after the mid-term evaluation of the Lisbon Strategy in 2004 when economic, employment and social policies were better integrated by implementing common guidelines and using a common reporting system, the National Reform Programmes.

and employment field, most European coordination takes place through soft law mechanisms, namely, the open method of coordination, (OMC) with little leverage for putting pressure on member states to implement or desist from certain policies. As part of the OMC, recommendations are issued (see below) but there are no sanction mechanisms.

The components of inclusive growth, in the Europe 2020 definition, are increasing employment, improving skills and fighting poverty (European Commission, 2010c, p.16-18). Under the general heading of poverty child poverty in particular, but also the working poor and the exposure of the unemployed to poverty are in focus. It can be considered a step forward that the social dimension has been integrated into the overall Europe 2020 Strategy, but the fact that it is so closely intertwined with employment issues makes it uncertain whether and how member states will address the social inclusion guideline (Zeitlin, 2010, p. 262).

The new Europe 2020 poverty target – to lift 20 million (or one in six) people out of poverty and social exclusion – reflects the need for political compromise (for details, see Mailand, 2011). This is illustrated notably by the fact that the EU27 target is measured on the basis of three combined indicators: at-risk-of-poverty rate,⁷ severe material deprivation rate⁸ and households with very low work intensity.⁹ This combination of monetary (relative income poverty) and non-monetary (material deprivation and exclusion from the labour market) components of poverty is supposed to reflect the multifaceted nature of poverty.¹⁰ A key point is that member states can choose whether they want to use the composite EU definition for monitoring poverty or to set targets on the basis of a subset of the three indicators or on the basis of national indicators reflecting the specific country situation. Most countries have

7. Persons with an equivalised disposable income below the at-risk-of-poverty threshold, which is defined as 60 per cent of the national median equivalised disposable income after social transfers.

8. Severe deprivation is defined as experiencing at least four out of nine deprivation items. The deprivation items are as follows: cannot afford to: pay rent or utility bills; keep home adequately warm; face unexpected expenses; eat meat, fish or a protein equivalent every second day; take a week's holiday away from home; or buy a car, a washing machine, a colour TV or a telephone.

9. Defined as persons aged 0–59 living in households where adults worked less than 20 per cent of their total work potential during the past year.

10. For detailed information on the social dimension of the Europe 2020 Strategy see Council of the European Union, 18 February 2011.

applied the EU definition but an important subset of countries uses other definitions, the most popular being the ‘at-risk-of-poverty rate’ (for a provisional list, see Council of the European Union, 2011b, p. 3-4).

In what follows, we focus on the poverty headline target as an indicator of inclusive growth. Previous assessments of the Lisbon Strategy that also focused on growth, employment creation and skills upgrading suggest disappointing outcomes with regard to poverty (Cantillon, 2011). Other research has also pointed out that substantial inequalities exist within groups of people with similar skill levels (Franzini, 2011). In other words, employment growth and skills acquisition have been shown to be far from unequivocal paths to more social cohesion, even when macroeconomic conditions were more conducive than currently. Depressed output growth, massive increases in unemployment and pressures to decentralise collective wage bargaining are likely to make these links even weaker. For these reasons, we focus on the poverty headline target.

3.2 Economic governance reforms

The Europe 2020 Strategy was drawn up and launched at a time when the European economy – and especially the Eurozone – was facing the deepest economic crisis since its inception. In the case of the Eurozone, the debt crisis exposed the shortcomings in the economic governance architecture put into place starting in 1992. The European responses to the debt financing crisis that started in Greece were: first, the setting-up of an IMF/EU/EC financial support package for Greece; second, the establishment of the European Financial Support Facility (EFSF) (due to be replaced by a so-called European Financial Support Mechanism ESM) aimed at supporting Eurozone governments facing prohibitively high interest rates for financing their debt in the markets; and third, the launch of the Securities Markets Programme (SMP) under which the ECB began buying Eurozone governments’ bonds.

The spreading of the crisis and its potential implications forced a rethink with regard to the economic governance institutions and procedures that were in place with a view to ensuring that it would not occur again, but also that, if it did occur in future, there would be sufficient resources to tackle it effectively.

Draft legislation¹¹ was proposed by the European Commission and discussed by the European Council. At the time of writing the European Parliament had just adopted these measures, the so-called 'six-pack' of economic governance reform proposals.¹² Nonetheless, many details remain to be operationalised.

The thrust of these proposals can be summarised in three points:

- (i) the introduction of a European semester to intensify policy coordination;
- (ii) the introduction of a so-called Excessive Imbalance Procedure to address the issue of external (current account) imbalances; and
- (iii) a strengthening of the fiscal rules under the Stability and Growth Pact (SGP) (for a more detailed discussion of these changes, see also Watt, 2011).

Enhanced policy coordination: the European Semester

The coordination of national policymaking is being streamlined in a new annual procedure known as the European semester, applied from the start of 2011. The process got under way in January with the publication by the European Commission of the Annual Growth Survey (AGS) (Vanhercke, 2011). The Annual Growth Survey 2011 focused on fiscal consolidation and labour market reform: the implicit deal was that this tough neoliberally-inspired package was a quid pro quo for the setting up of the EFSF and the ESM. The 2011 AGS does not contain a single reference to social inclusion or social cohesion – the 'inclusive growth' paradigm is in fact reduced to its employment component with no regard to the issue of fighting poverty (European Commission, 2011b). Rigorous fiscal consolidation is put at the centre and strict and sustained wage moderation are suggested as corrective measures for member states with large current account deficits and high levels of indebtedness (European Commission, 2011b, 5); surplus countries, by contrast, are not called upon to accelerate wage growth to bring about symmetrical competitive adjustment (ETUI/ETUC, 2011, ch.1).

11. See http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-09-eu_economic_governance_proposals_en.htm

12. See <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/647&format=HTML&aged=0&language=EN&guiLanguage=en/>

The policy prescriptions with regard to job creation are primarily supply-side, focusing on making work pay by strengthening incentives and conditionality, despite the overwhelmingly demand-side nature of current unemployment problems. Social inclusion/fighting poverty is discussed briefly only in Annex 1 (European Commission, 2011a). Here the focus is clearly on the role of labour market participation (including incentives) in fighting poverty (compare European Commission, 2011a). The potential merits of this approach have already been cast into doubt, however: growth and employment during the Lisbon Strategy era failed to deliver in terms of reducing poverty (Cantillon, 2011).

For the present discussion the key feature of the European semester is that it is serving to increase the pressure on member states to pursue fiscal austerity while at the same time seeking to reduce unemployment by implementing orthodox market-oriented structural reform policies. In a context in which unemployment is high primarily for cyclical (demand-side) not structural (supply-side) reasons, such an approach is likely not only to be ineffectual in reducing unemployment, but also to have negative distributional effects. Both are inimical to the goal of stable and inclusive growth.

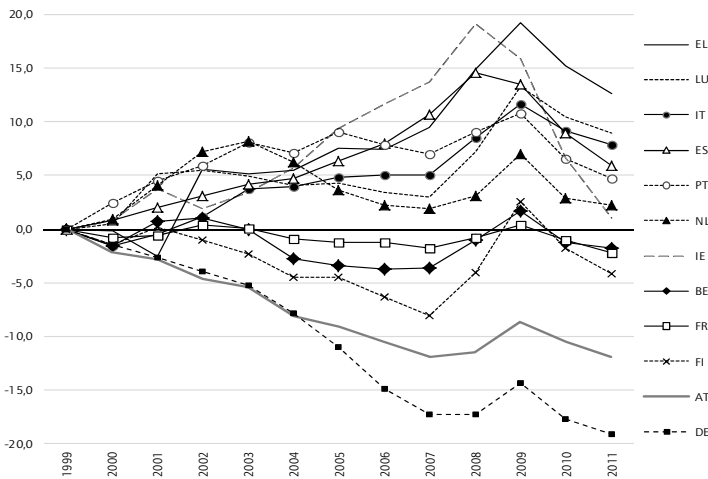
Addressing current account imbalances

The surveillance of Member States is also to be substantially broadened in comparison to the previous emphasis on the fiscal stance. A new, so-called excessive imbalance procedure (EIP) is to be introduced, modelled on the excessive deficit procedure in the SGP. Under the EIP the competitiveness and current account positions (see Box 1) of all member states are to be assessed against a 'scoreboard' of relevant indicators (the precise details of which have yet to be decided). The Commission and the Council can make recommendations to member states if the imbalances are held to be excessive and injurious. Like the SGP there is also a corrective arm under which member states (in the Euro area) can be sanctioned for failing to comply with recommendations. A country can be required to deposit up to 0.1 per cent of GDP with the European Commission which, in the case of repeated non-compliance, can be converted into a fine. Decisions on sanctions are taken by the Council, but subject to a new 'reverse majority' procedure, whereby the member state threatened by sanctions will have to obtain a qualified majority to overturn the recommendation (as opposed to a qualified majority being necessary in order to endorse the sanction recommendation).

Box 1 Current account imbalances in the Eurozone

One widely drawn lesson of the economic crisis is that current account imbalances are a problem, not only at the global level (for instance, the United States and China), but also between countries that share a common currency.¹³ Such imbalances arose because of the workings of EMU (See Theodoropoulou and Watt, 2011). On joining EMU, previously high-inflation European countries on the southern and western periphery that had had high interest rates benefited from a sharp fall in borrowing costs, setting off a – seemingly – virtuous circle: these fast-growing, high-inflation economies enjoyed relatively low real interest rates (the common ECB-rate minus their high inflation rates). This stoked up economic activity, also by driving up asset – especially house – prices, which in turn stimulated the economy through various wealth effects. Meanwhile, slow-growing, low-inflation countries were mired in a mirror-image vicious circle, facing slow growth and low inflation with relatively high real interest rates.

Figure 6 Nominal unit labour costs minus 2% p.a. (1999 = 100)



Source: AMECO database; authors' calculations.

13. For most purposes it is an acceptable simplification to equate current account (im)balances with trade imbalances. Deficits, then, arise when a country imports more goods and services than it exports; conversely, surpluses are the result of a country exporting more than it imports. Countries running persistent deficits incur net liabilities (foreign debts) vis-à-vis the rest of the world (or run down net asset positions accumulated in the past), while surplus countries build up net asset positions (or pay down past liabilities).

This dichotomy was exaggerated by the one-sided nature of the Stability and Growth Pact: slow-growing economies are prevented from pursuing expansionary fiscal policies, while faster-growing economies are not constrained. This situation led to sustained faster nominal wage/price growth in peripheral countries than in core countries. The combination of faster-rising prices and nominal wages, and stronger domestic demand constrained deficit countries' exports while stoking import demand; the reverse happened in surplus countries. In Germany, domestic demand was essentially stagnant and economic growth was driven solely by higher net exports. The widening competitiveness differentials are shown in Figure 6.

The figure is presented in such a way (subtracting 2 per cent a year from the raw nominal unit labour cost figures) that a country keeping close to the x -axis would see domestic prices and unit wage costs growing in line with the ECB inflation target. France and Belgium are in this category. Germany and Austria experienced a marked increase in wage competitiveness (taking 1999 as a starting point) over the period, whereas the 'peripheral' economies, such as Ireland, Greece and Spain, lost competitiveness in the period up to the crisis.

Reinforced fiscal policy surveillance

The surveillance of fiscal policy under the Stability and Growth Pact (SGP) is reinforced considerably under the new proposals. One notable change is an insistence on compliance with the debt criterion (60 per cent of GDP), which had previously essentially been ignored. Countries will be required to achieve rapid downward adjustment towards the threshold (one-twentieth of the gap between the current and target debt-to-GDP ratio per year). The sanctions regime under both the preventive and corrective arm of the Pact is to be tightened, with a more graduated range of sanctions, coupled with the application of the reverse voting mechanism (see above) that makes it harder for member states to block a Commission recommendation to impose sanctions. There is to be particular regard to the expenditure side of the budget, with a norm of linking expenditure to the medium-term rate of economic growth. More attention is also to be paid to fiscal institutions in the member states in order to improve the basis for decision-making and ensuring the provision of correct data.

Assessment

A more detailed critique of this approach is provided by Watt (2011). In brief, while marking progress in some important areas the proposals are a step backward in others and, indeed, raise major concerns. Not least, a number of potential reforms, given the experience of the crisis, are notable by their absence.

In procedural terms the European semester can be welcomed as bringing about much needed policymaking coordination. It is a step in the direction of 'economic governance' that many from the outset considered indispensable for the operation of a monetary union. The problem, at least in the first year of its operation, has been (as we have seen) the misguided substantive thrust given by the Annual Growth Survey. One important focus of the reforms is an intensification of a longstanding – but arguably unjustified and unhealthy – European obsession with fiscal deficits and public debt. Not least this raises the danger of a dangerous intensification of fiscal austerity and neglecting cyclical stabilisation. The focus on the expenditure side is likely to have negative distributional implications and thus is inimical to inclusive growth.

The attention to be paid to macroeconomic imbalances is, in principle, justified in light of what has been learned during the crisis (see Box 1). The issue here is more whether the 'devil lies in the detail'. There are serious concerns about how wage setting at the national level is supposed to be 'policed' by policymakers at both EU and national level. Much of the language used by policymakers in the context of the EIP (and also some of the recommendations in the AGS) gives rise to the fear that the focus will be one-sidedly on deficit countries, rather than taking a symmetrical approach to the correction of imbalances. Again, this is both a macro problem and a problem of distributional justice.

Above all, the reforms represent a missed opportunity to use the crisis to make changes that would enhance growth and employment opportunities in Europe and improve the welfare of European citizens. Notably absent from the reforms is any reference to the role of monetary policy within economic governance. Other matters urgently requiring reform – such as limiting tax competition between EU countries – are not addressed.

As if these initiatives – driven by the standard 'community method' involving Commission, Council and Parliament – were not enough, member states have been pushing their own intergovernmentalist

agenda.¹⁴ France and Germany launched an initiative in early 2011 for a so-called 'Competitiveness Pact'. This led to a more consensual effort within the European Council: renamed 'Pact for the Euro' it contained a firm commitment to an effective ESM, alongside a more detailed set of measures to which Euro area member states were to commit themselves.

Measures are to be taken in the following areas: competitiveness, job creation, fiscal consolidation and financial stability. There are no provisions for compulsion or sanctions on member states: peer pressure will be relied upon. Only those actually seeking the support of the EFSF/ESM will be forced to make policy changes. The Pact immediately prompts the question of why we need a (non-binding) intergovernmental Pact for the Euro when the European semester and the Annual Growth Survey constitute a very similar process of policy coordination, albeit with – ultimately – the possibility of imposing sanctions (Watt, 2011). What is explicit in the Pact is the 'grand bargain' nature of the deal: European solidarity in the form of the ESM for greater policy constraints. This was only implicit in the AGS. The latest manifestation is the so-called Euro-Plus Pact agreed in March 2011, to which the Euro area members and a number of non-members (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) have signed up.

The latest initiative (August 2011) is another Franco-German plan. Most notable here is the insistence that all countries institutionalise debt brakes/balanced budget rules in their constitutions, along the lines of the German *Schuldenbremse*. Putting operational policy rules into a hard-to-amend constitution is bad politics. Such rules tend to be complex simply because the world is complex and they are likely to have to be modified as circumstances and our knowledge of the functioning of our economies changes. Depending on how it is implemented it is also bad economics: the crisis has taught us that countries in a monetary union, with a single monetary policy, need to use fiscal policy actively to address their specific national situations and promote Euro-

14. An overview of this intergovernmentalist track is to be found here and the links contained within it: <http://www.social-europe.eu/2011/08/another-franco-german-summit-another-mix-of-bad-process-and-ambiguous-outcomes/>

area cohesion. Tying the hands of policymakers with cumbersome, hard to change and/or hard to interpret rules is not the way forward.

Overall, Europe is developing an almost bewildering array of overlapping policy responses in the area of economic governance. Beyond this confusion, none of the measures proposed, singly or jointly, come close to resolving the key problems facing the Euro area.

In the context of the present discussion, which focuses on the prospects for inclusive growth, it can be concluded that the economic governance reforms are based to a considerable extent on a misdiagnosis of the problem ('it's mostly fiscal' and more market-oriented structural reforms are needed). This does not (yet) constitute an adequate response to the crisis and thus threatens, in the short run, to harm any prospect of economic growth and to increase the risk of a renewed downturn. Exacerbating the shift to Continent-wide austerity makes swift recovery of demand and output unlikely. It also promotes policies (expenditure-side forced consolidation, decentralisation of collective bargaining and a 'make work pay' approach to labour market policy) that will tend to make any growth that does occur less 'inclusive' (see also next section). Finally, it risks embedding retrogressive policies in the longer term (such as a debt brake), thereby depressing public investment.

4. Fiscal austerity against inclusive growth?

Having argued that the new economic governance and fiscal austerity in Europe as a response to the debt crisis pose a serious threat to any kind of output growth – and consequently to employment creation and recovery – we shall now take a closer look at the planned national measures for achieving the poverty headline target of the Europe 2020 Strategy. These measures were announced in the context of the European Semester last spring. We ask the following questions: do fiscal consolidation policies overshadow policies aimed at reducing poverty in its various guises? Are the policies planned in the context of the European Semester mutually supportive and likely to increase cohesion across member states? And which objective is the EU's priority: consolidation of public finances or poverty reduction?

To answer these questions, we proceed as follows. Section 4.1 highlights how the EU countries are doing in terms of poverty and social exclusion. Section 4.2 illustrates the extent to which the pressure for fiscal austerity is contradicting the inclusive growth paradigm and particularly its social component. This is done, first, by looking at the planned expenditure cuts – and particularly the cuts in social spending – that the countries report on in their Stability and Convergence Programmes. Second, we look at the emphasis of the Commission's country-specific recommendations as part of the policy cycle of the European Semester. Finally, we present some measures that are likely to have adverse implications for social inclusion and poverty from selected countries.

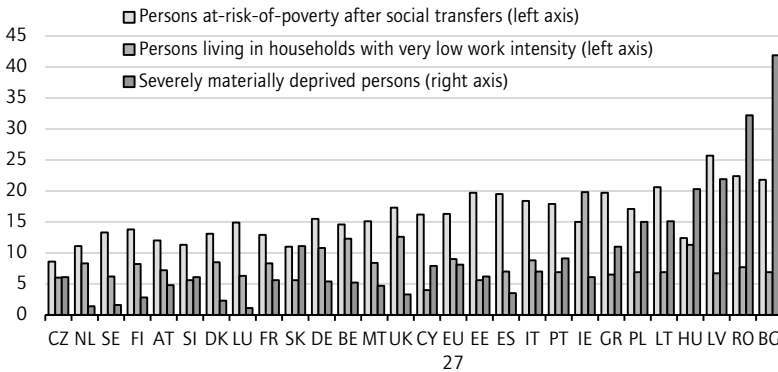
4.1 Poverty and social exclusion in the EU

Figure 7 shows how the EU countries were faring with regard to the overall EU headline target on poverty and social exclusion and its three component sub-indicators in 2009 (latest available data). The overall target is composed of people who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with very low work intensity. The European Council (18 February 2011: 44–46) illustrates for all EU countries how the three groups overlap.¹⁵ In most countries the 'at risk of poverty rate' best accounts for the observed poverty, as measured by the composite indicator. However, in the poorest countries – Bulgaria, Romania, Latvia and Hungary – 'severe material deprivation' is very pronounced, whereas it is of limited importance in most other countries. In Ireland, the most acute dimension of poverty is represented by 'low work intensity households'. The overall indicator capturing people at risk of poverty or social exclusion ranges from 14 per cent of the total population in the Czech Republic to 46 per cent in Bulgaria; the EU average was 23 per cent in 2009. Eight countries had more than one in four people (>25 per cent) in poverty according to the EU definition: (in ascending order) Ireland, Greece,

15. It is important to keep in mind that the EU headline target refers to relative poverty, implying that poverty means very different things when comparing, for example, the Nordic and the Central and Eastern European countries. For comparative purposes and to stick with the European definition we will nevertheless use the EU headline target here.

Poland, Lithuania, Hungary, Latvia, Romania and Bulgaria. The Nordic countries are doing particularly well and the continental European countries all perform above average. The Southern European countries exhibit below EU average performance but, with the exception of Greece, are not among the worst performers. The EU2 countries are by far worst performing and the NMS are spread over the whole distribution, with the Czech Republic being the best performer overall.

Figure 7 The overall EU headline target (people at risk of poverty or exclusion) and its three components, 2009 (share of total population)



Source: Eurostat online database.

All five countries (Greece, Portugal, Ireland, Latvia and Romania)¹⁶ that are currently in receipt of financial assistance (or under precautionary surveillance in the case of Romania) from the EU and the IMF and are thus under particular pressure to engage in rapid fiscal consolidation have poverty and social exclusion rates above the EU average. The

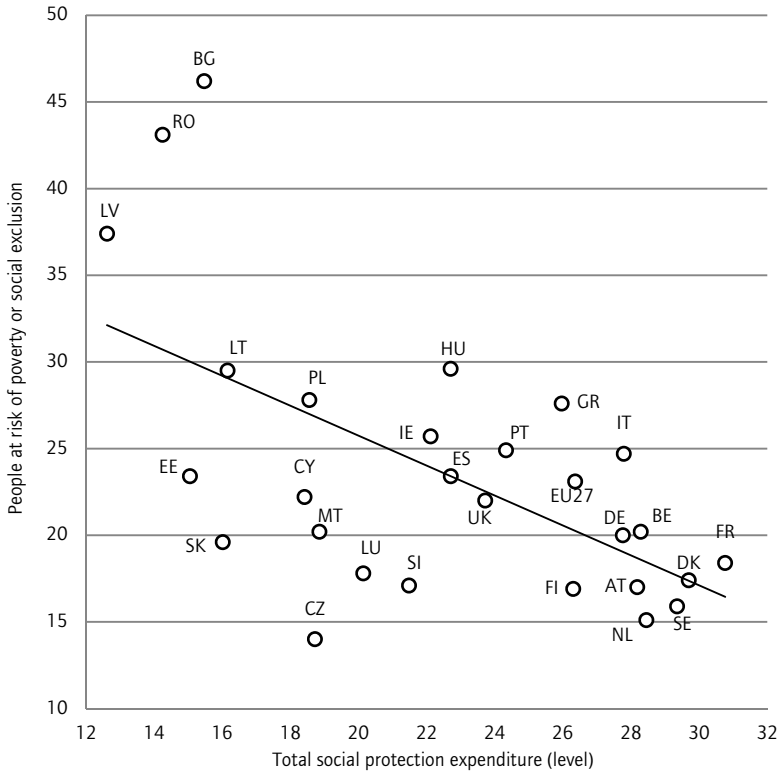
16. Latvia and Romania had to seek multilateral balance-of-payments assistance from, among others, the EU, the IMF, the World Bank and the EBRD in 2008 and 2009, respectively. To that end, they adopted conditionality programmes spelling out the structural reforms they had to undertake. While Romania completed the first programme and is now under a non-activated 'precautionary' programme, Latvia's adjustment is still ongoing. Hungary also received balance-of-payments assistance, although it stopped receiving it before the foreseen end. Greece, Ireland and Portugal had to seek financial assistance from the EU and the IMF in May 2010, December 2010 and May 2011, respectively, as their governments faced prohibitive borrowing costs in the financial markets, following rising concerns that they would not be able to carry on servicing their debt.

following sections will illustrate the negative impact of the pressure for fiscal austerity on the inclusive growth paradigm and point particularly to the danger of countries drifting apart.

4.2 Stability and Convergence programmes against reforms to tackle poverty?

We examine first the plans announced by member states with regard to developments in public expenditure and, particularly, social payments in the context of their Stability and Growth programmes. To put the announced cuts into perspective, Figure 8 illustrates how the different member states are doing in terms of the level of total social expenditure as a share of GDP in 2008 (latest available data from Eurostat) and the share of total population at risk of poverty or social exclusion in 2009 (the reference year for the Europe 2020 headline target). There is substantial variation in levels of social spending and associated risks of poverty and social exclusion. However, we see that in terms of social spending we can roughly distinguish two clusters of member states, namely the old and the new member states. Within these two clusters, there appears to be a negative correlation between social payments and the risk of poverty/social exclusion, which in fact is stronger among the new member states. In other words, the new member states, which are also significantly poorer on average than the old ones, have lower levels of total social spending as a share of GDP, while also presenting a wider variation of poverty risk, with some of the worst performers in the EU (Romania, Bulgaria, Latvia) but also the best performer (Czech Republic). In terms of the Europe 2020 Strategy, one would therefore expect that at least those member states with higher poverty risk rates would be called upon to make relatively more effort to increase social spending as a share of GDP in order to make progress towards their poverty headline target.

Figure 8 Comparison of levels of total social protection expenditure as a percentage of GDP and risk of poverty or social exclusion rate



Source: Eurostat online database.

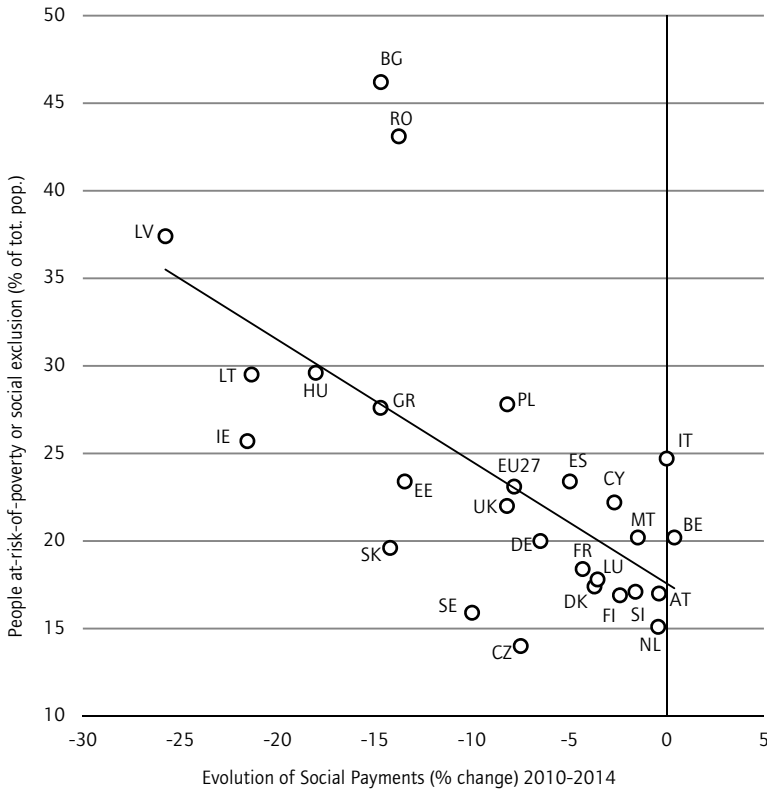
Figure 9 presents the risk of poverty or social exclusion in 2009 and the planned evolution (percentage change) of social payments (including both money transfers and transfers in kind) as a proportion of GDP for 2010–2014, according to the Stability and Growth Programmes which were submitted in spring 2011 in the context of the European Semester (see Annex for complete tables on the development of total public ex-

penditure and social payments).¹⁷ Cuts in social payments are envisaged in the majority of member states, although they are most severe in Ireland, Greece, Latvia, Hungary, Lithuania, Slovakia, Bulgaria, Estonia and Romania, which are also among the countries with the highest proportion of the population at risk of poverty or exclusion. Ireland, Greece, Latvia and Romania have received financial help from the EU and/or the IMF and can thus be considered to have suffered a loss of policymaking autonomy. This is not the case for Lithuania, Estonia, Slovakia and Bulgaria. Estonia was under pressure to demonstrate a commitment to sound public finances as it joined the euro in 2011,¹⁸ however, while Lithuania is in a similar situation as it has been hoping to adopt the euro since 2007. Interestingly, Latvia, Slovakia, Lithuania, Bulgaria, Romania and Estonia have all had and are projected to have public debt to GDP ratios well below the 60 per cent that the Stability and Growth Pact stipulates. This implies that there are few fundamental concerns about the sustainability of their public finances. There are certainly concerns about the social exclusion of particular groups within their populations, however, and the planned cuts in social payments risk aggravating the situation. Overall, the positive correlation between the extent of poverty/social exclusion and the extent of the planned retrenchment of social spending is profoundly worrying and completely at odds with the EU poverty headline target.

17. These figures are the only ones available for the current period and the near future. It should be noted that the Eurostat definition of social payments as used in Figure 8 is different to the one used for the purposes of Stability and Convergence Programmes (see Figures 9 and 10) in that the former includes all costs associated with a social policy programme (for example, administration costs), whereas the latter measures the payments themselves only. That results in a discrepancy in the size of social payments which is fairly large for some countries (such as Sweden, Denmark and Finland) but not others. However, we think that, given the absence of more recent Eurostat data and forecasts on these payments in the forthcoming years, this discrepancy does not affect the analysis.

18. Countries giving up their currency and monetary policy tools become vulnerable to financial markets' beliefs about their capacity to carry on servicing their public debt, as they lose control over their central bank. As the current crisis has shown, a market belief that a government cannot carry on servicing its debt can become a self-fulfilling prophecy, once market participants start requiring a higher interest rate in order to continue lending money to the government. See (DeGrauwe, 2011b).

Figure 9 Risk of poverty or social exclusion (2009) and planned evolution of social payments, 2010–2014 (%)

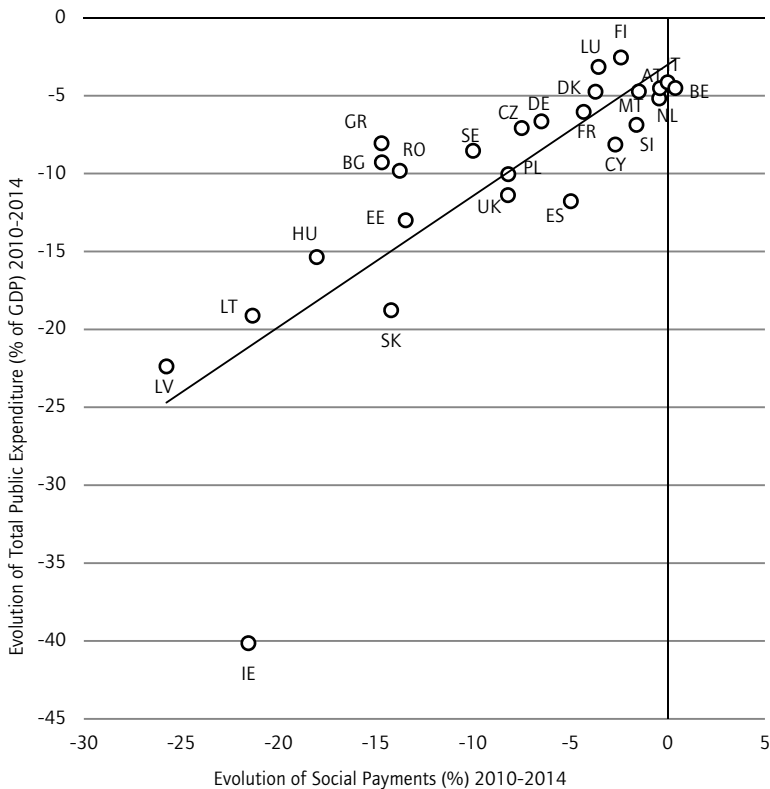


Source: National Stability and Growth Programmes, DG Ecfm and Eurostat online database.

To what extent are these planned social cuts in line with more general cuts in public expenditure and how much do they reflect a planned rolling back of the welfare state alone? Figure 10 shows how the planned evolution of social expenditure compares to the planned evolution of public spending between 2010 and 2014 according to the Stability and Growth programmes of 2011. A few points stand out. First, the retreat of the welfare state within the framework of public spending retrenchment is severest in Greece, Bulgaria and Romania. Greece and Latvia have received EU/IMF financial support and have therefore been following

strict conditionality programmes. Second, the retreat of the state and of the welfare state is more pronounced in some of the new member states whose populations are at relatively high risk of poverty, such as Latvia and Lithuania. Third, Ireland has planned by far the biggest cut in public spending (which has to do with the state's guarantees to its banks) and it is therefore difficult to tell whether the rolling back of its social spending is otherwise bigger or smaller than the cuts in public spending as a share of GDP.

Figure 10 Evolution of public and social expenditure, 2010–2014 (%)



Source: National Stability and Growth Programmes, DG Ecfm.

The picture that emerges from these data is that the countries with disproportionate cuts are those that are already doing comparatively badly in terms of poverty and social exclusion. More specifically, especially in those countries in which the EU has had a say in how much the state could spend and what issues it should be focussing on within the framework of financial aid programmes, there has been a rolling back of both public expenditure and social payments.

4.3 EU priorities: predominance of fiscal issues in the country-specific recommendations

Under the impact of the economic crisis on public finances, the alignment of macroeconomic reporting (Stability and Convergence Programmes) and reporting on structural reforms (National Reform Programmes) in the context of the European Semester has to some extent overshadowed the Europe 2020 targets and particularly the inclusive growth agenda. Countries are to give priority to macro-fiscal issues (compare, for example, European Commission, 2010b, 2011b). This is expressed, for example, in the 2011 Annual Growth Survey which, as we have seen, is primarily fiscal in orientation, combined with a neoliberal supply-side reform agenda.

The same predominance of fiscal consolidation is evident when looking at the next step in the European Semester, on which we focus in this section: the drawing up of country-specific recommendations based on the submission of the Stability and Convergence and the National Reform Programmes (NRPs). Interestingly, although the NRPs are now submitted at the same time as the Stability and Convergence Programmes, macroeconomic surveillance is still an important element. On the basis of the Stability and Convergence Programmes and the NRPs, country-specific recommendations are issued by the European Commission and must be approved by the European Council.¹⁹

19. Country-specific recommendations as well as national reform programmes and stability programmes can be found here: http://ec.europa.eu/europe2020/tools/monitoring/recommendations_2011/index_en.htm

What do these recommendations reveal about the relative priority of fiscal consolidation – as pursued in the context of new economic governance and policies to deal with the debt crisis – over policies to tackle poverty? A first interesting point is that the countries in receipt of financial assistance from the EU and the IMF did not receive specific recommendations from the European Commission this year but instead were called upon to implement the measures laid down in their respective memoranda of understanding. At most, these memos contain general clauses stipulating that the most vulnerable segments of the population should be shielded from the impact of the fiscal consolidation measures. However, the specificity of actions to that end does not parallel those of reducing budget deficits, while measures of a more positive nature that could actively help to reduce poverty are not mentioned at all (European Commission, 2011d; Ministry of Finance-Hellenic Republic, 2011; Portuguese Ministry of Finance and Public Administration, 2011). On the contrary, minimum wage cuts have been effected already in Ireland and Greece and have been under consideration in Portugal (Portuguese Ministry of Finance and Public Administration, 2011). Last but not least, in plans for reforming pension and social security systems, ‘sustainability’ clearly takes precedence over adequacy of benefits; in fact, the latter is often simply not considered.

Each of the remaining 22 countries received a recommendation on budgetary discipline (always the first recommendation), whereas the remainder of the recommendations vary considerably in content. As regards the Europe 2020 priority of inclusive growth, labour market inclusion largely predominates over wider poverty prevention goals. Eighteen countries – and among them the three countries with the highest employment rates – received recommendations on improving labour market participation with particular emphasis on strengthening incentives.²⁰ Recommendations on education and training were issued to 16 countries and in the field of pensions to another 16; again, incentives for labour market participation stand centre-stage (for example, abolishing early retirement schemes and increasing effective

20. Recommendation 5 to the Euro area, for example, asks that they ‘pursue further tax reforms which give priority to growth-friendly sources of taxation while preserving overall tax revenues, in particular by lowering taxes on labour to make work pay’. In a similar vein several countries are asked to reduce financial disincentives for second earners or for low (and medium) paid workers.

retirement age). With regard to pensions, adequacy is also mentioned in a number of cases. Eight countries received recommendations on wages (with an emphasis on aligning wage growth and productivity) and seven on public services, in most cases with a focus on improving effectiveness.

A number of these measures may be helpful in fighting poverty and social exclusion, but they are more likely to work when job creation is buoyant and some redistribution policies are in place. Only six countries received recommendations on poverty and social exclusion, namely Bulgaria, Hungary, Estonia, Cyprus, the United Kingdom and the Netherlands.²¹ Interestingly, of the three countries that do particularly badly with regard to the EU poverty headline target (Bulgaria, Romania and Latvia) only Bulgaria received a recommendation on fighting poverty. Member states use different national indicators to report on poverty, and the respective sections in the NRPs thus vary substantially in content and length. This is likely to have rendered the process of giving recommendations with regard to poverty more difficult. Last but not least, four countries received recommendations on health care.

Five of the seven recommendations to the Euro area countries, which receive specific recommendations from the Commission, focus on macro-economic issues (fiscal discipline, stability of financial system, commitment to Euro Plus Pact and enhancing competition in services) (compare Council of the European Union, 2011a). The remaining two recommendations call for reforms to social security systems with an emphasis on fiscal sustainability and adequacy and tax reforms, for example, to make work pay with a focus on growth-friendly sources. The accompanying, more detailed document (European Commission, 2011c) does not contain a single reference to inclusive growth and the detailed table entitled 'labour market and social indicators' provides figures on labour productivity and unit labour cost growth instead of the poverty and social inclusion indicators.

To wrap up, at the level of the country-specific and Euro area recommendations, not only do the outcomes of macroeconomic prescriptions risk

21. The recommendations to Hungary and the Netherlands are only indirectly linked to the poverty headline target, emphasising tailor-made programmes to low skilled and other disadvantaged groups and the labour market integration of vulnerable groups.

running counter to the coordination related to smart, sustainable and inclusive growth, but the inclusive growth paradigm, where it is referenced, seems to be strongly driven by a desire to boost labour force participation, largely based on making-work-pay strategies that are of dubious value in a context of unemployment caused primarily by a shortfall of aggregate demand.

4.4 Evidence from the fiscal austerity packages

To underpin our argument, in this section we have used evidence from national experts (Theodoropoulou and Watt, 2011) and other sources on the austerity programmes adopted by late 2010/early 2011 in 17 EU member states to obtain insights into their effects on poverty and social inclusion (on austerity measures and their social impacts, see also the individual chapters of this volume).

Indirect tax hikes, which tend to disproportionately affect those at the low end of the income distribution, were reported in several countries (Poland, Hungary, Estonia, Cyprus and Latvia), most of them at the higher end of the poverty distribution within the EU. Indeed, the EU recommendations state that tax increases, wherever necessary, should focus more on indirect taxes as these are less likely to interfere with employment creation (European Commission, 2010d). Nonetheless, some countries (France, Austria, Luxembourg and the United Kingdom under the previous Labour administration) increased progressive taxes (income and wealth taxes). Heise and Lierse (2011), who assess the impact of austerity measures on the European social model for seven European countries, also come to the conclusion that in all these countries the economic crisis and the resulting public debt have been used as excuses for social cuts which in most countries disproportionately hit low earners.

Substantially regressive effects for the bottom end of the income distribution have been reported in the United Kingdom as a consequence of the tax and benefit changes pursued by the government there (Browne and Levell, 2010; Horton and Reed, 2010). Moreover, in Denmark, following the measures introduced for 2010, it has been estimated that by 2013 the poorest 10 per cent are likely to lose 0.78 per

cent of their income compared to only 0.03 per cent of the richest 10 per cent (Baadsgaard, 2010).

The young working under precarious employment contracts are particularly hard hit in Italy due to the limited coverage of unemployment insurance. The unemployment rate for those under 25 in Italy stood at 27.8 per cent in 2010 (Eurostat LFS data), more than three times higher than the average which was 8.4 per cent (Theodoropoulou and Watt, 2011). This implies a concentration of social exclusion in this group.

In a similar vein, in Greece (for details, see Matsaganis and Leventi, 2011), because of their very low coverage by unemployment insurance, the unemployed have been particularly affected by the fiscal austerity programme that is a condition of the financial support the country receives from the EU and the IMF. Pensioners have also been targeted. Indirect tax increases have been regressive. Some measures, however, such as some elements of public sector retrenchment, have tended to narrow the income distribution (Matsaganis and Leventi, 2011). Overall, as a result of the austerity and the wider recession, 5 per cent of the Greek population saw their 2010 incomes fall below the 2009 poverty line, swelling the ranks of those who were already in poverty (another 20 per cent of the population). However, while the crisis has raised demand for social protection, the supply of social benefits has been reduced rather than increased.

Social benefit recipients are ill-affected following cuts in Latvia, Romania, Germany, the United Kingdom, Spain and Ireland (Heise and Lierse, 2011, p.24-26). In Portugal, the recipients of non-contributory benefits (social assistance, which is more likely to be received by people at the margins of the labour market) are likely to suffer most following measures to reduce expenditure on these benefits within the framework of the programme imposed as a quid pro quo for financial support from the EU and the IMF (Portuguese Ministry of Finance and Public Administration, 2011). Again, it is worth noting that the majority of these countries are at the upper end of poverty distribution in the EU, and have also been finding it hard to finance their public debt in the markets.

5. Conclusion

Europe is currently going through the worst economic crisis of the post-War era. Unemployment has increased dramatically in several countries, especially among young people, and the prospects for output growth recovery appear gloomy for the next few years. Due to the economic interdependence of EU member states, these developments are likely to spread across the Union and especially within the Eurozone. Past experience shows that this combination of high unemployment and prolonged weak output growth is bound to lead to persistently high unemployment, the depreciation of skills and the labour market detachment of unemployed people. The social consequences of these developments will be grave as social exclusion is likely to increase.

Against this background, we have sought to evaluate the coherence of the policy responses promoted at the EU level in response to the crisis and the quest for growth. We have investigated whether the pursuit of fiscal austerity as dictated in the context of the European Semester runs counter to the pursuit of inclusive growth through reducing poverty, which is one of the priorities of the Europe 2020 Strategy. Our answer is affirmative and our argument is spelled out along two axes.

First, the underlying principles of the proposed new economic governance structures are bound to impose a fiscal austerity bias which, under the current circumstances, will inevitably lead to depressed demand and no output growth in the short, medium and, due to hysteresis mechanisms, eventually the long term. This is inimical to growth as such, but is also expected to make any growth that is achieved less inclusive.

Second, a closer look at the recommendations to member states and their declared stability and convergence programmes suggests that all policy considerations with regard to tackling poverty and social exclusion are subjugated to fiscal consolidation and other goals. It is not the first time that inclusive growth has been subordinated to other issues, such as macroeconomic concerns, productivity and employment growth, but the crisis and the subsequent austerity measures have further emphasised these tendencies. This predominance of public finance concerns over inclusive growth is particularly striking in the cases of member states that have been performing below the average in terms of poverty and social exclusion, but have no particular problems in terms of the

sustainability of their public finances. To that end, we have also provided some evidence from austerity packages already adopted in selected member states (as available) and how they have been adversely affecting vulnerable groups or doing little to improve their position. The crisis could and should have been used as an opportunity to introduce corrections to the previous growth model, of which rising inequality was a prominent feature (Watt 2009). However, the evidence suggests not only that this has not happened, but that current policies are tending to exacerbate the direct negative effects on distribution and poverty/exclusion arising from the crisis itself.

Annex

Table A1 Evolution of total public expenditure 2010–2015, according to Stability and Growth Programmes 2011 (% of GDP)

	2010	2011	2012	2013	2014	2015	2014–2010 (p.p.)	2014–2010 (%)
LV	42.9	42.8	39.4	36.3	33.3		-9.6	-22.4
IE	67.0	45.5	43.7	42.4	40.1	37.8	-26.9	-40.1
LT	41.3	39.2	40.2	35.7	33.4		-7.9	-19.1
HU	48.8	49.7	44.1	42.5	41.3	40.3	-7.5	-15.4
EL	49.6	49.5	49.1	47.6	45.6		-4.0	-8.1
BG	37.7	37.2	36.8	36.4	34.2		-3.5	-9.3
SK	41.0	37.9	35.6	34.7	33.3		-7.7	-18.8
RO	40.7	39.2	37.6	37.2	36.7		-4.0	-9.8
EE	40.0	40.3	40.4	36.8	34.8	33.3	-5.2	-13.0
SE	52.7	51.3	50.0	49.0	48.2		-4.5	-8.5
UK	47.4	46.5	45.4	43.8	42.0		-5.4	-11.4
PL	45.8	45.7	43.7	42.2	41.2		-4.6	-10.0
CZ	45.2	46.2	45.7	44.0	42.0		-3.2	-7.1
DE	46.6	45.5	44.5	44.0	43.5	43	-3.1	-6.7
ES	45.0	42.7	41.4	40.5	39.7		-5.3	-11.8
FR	56.2	55.7	54.9	53.8	52.8		-3.4	-6.0
DK	56.8	55.8	56.6	54.2	54.1	53.3	-2.7	-4.8
LU	41.2	40.7	40.9	40.5	39.9		-1.3	-3.2
CY	46.7	46.1	44.4	43.4	42.9		-3.8	-8.1
FI	54.8	53.8	53.5	53.6	53.4	53.4	-1.4	-2.6
SI	48.0	48.0	48.2	46.0	44.7	43.1	-3.3	-6.9
MT	42.3	42.9	42.0	41.4	40.3		-2.0	-4.7
NL	50.2	49.0	48.3	47.7	47.6	47.6	-2.6	-5.2
AT	53.0	52.0	51.6	51.0	50.6		-2.4	-4.5
IT	50.6	49.7	48.9	48.7	48.5		-2.1	-4.2
BE	53.1	53.4	52.4	51.7	50.7		-2.4	-4.5
PT								

Source: National Stability and Growth Programmes, DG Ecfm.

Table 2 Evolution of social payments 2010–2015, according to Stability and Growth Programmes 2011 (% of GDP)

	2010	2011	2012	2013	2014	2015	2014–2010 (p.p.)	2014–2010 (%)
LV	13.2	12.4	11.2	10.5	9.8		-3.4	-25.8
IE	18.1	17.2	16.3	15.3	14.2	13.3	-3.9	-21.5
LT	15.0	13.9	13.7	12.6	11.8		-3.2	-21.3
HU	18.3	17.7	16.2	15.5	15.0	14.6	-3.3	-18.0
EL	23.8	23.3	22.5	21.4	20.3		-3.5	-14.7
BG	14.3	13.6	12.8	12.3	12.2		-2.1	-14.7
SK	19.0	18.1	17.6	17.0	16.3		-2.7	-14.2
RO	13.8	13.1	12.7	12.2	11.9		-1.9	-13.8
EE	15.6	14.6	13.9	13.7	13.5	13.3	-2.1	-13.5
SE	19.0	18.2	17.9	17.4	17.1		-1.9	-10.0
UK	13.4	13.2	13.2	12.9	12.3		-1.1	-8.2
PL	17.1	16.5	16.2	15.9	15.7		-1.4	-8.2
CZ	20.0	20.1	19.6	19.3	18.5		-1.5	-7.5
DE	26.2	25.5	25.0	25.0	24.5	24.5	-1.7	-6.5
ES	18.1	17.9	17.6	17.3	17.2		-0.9	-5.0
FR	25.5	25.4	25.1	24.7	24.4		-1.1	-4.3
DK	18.9	18.9	18.5	18.4	18.2	17.9	-0.7	-3.7
LU	19.7	19.4	19.5	19.4	19.0		-0.7	-3.6
CY	14.9	14.8	14.9	14.7	14.5		-0.4	-2.7
FI	20.8	20.2	20.3	20.3	20.3	20.3	-0.5	-2.4
SI	18.7	19.1	19.4	18.5	18.4	18.3	-0.3	-1.6
MT	13.5	13.5	13.6	13.5	13.3		-0.2	-1.5
NL	22.8	22.7	22.8	22.5	22.7	23.1	-0.1	-0.4
AT	25.5	25.3	25.3	25.4	25.4		-0.1	-0.4
IT	22.2	22.2	22.2	22.1	22.2		0.0	0.0
BE	25.3	25.4	25.4	25.4	25.4		0.1	0.4

Source: National Stability and Growth Programmes, DG Ecfm.

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A triumph of failed ideas European models of capitalism in the crisis

Edited by Steffen Lehndorff

The current crisis in Europe is being labelled, in mainstream media and politics, as a 'public debt crisis'. The present book draws a markedly different picture. What is happening now is rooted, in a variety of different ways, in the destabilisation of national models of capitalism due to the predominance of neoliberalism since the demise of the post-war 'golden age'. Ten country analyses provide insights into national ways of coping – or failing to cope – with the ongoing crisis. They reveal the extent to which the respective socio-economic development models are unsustainable, either for the country in question, or for other countries. This assessment holds not just for 'weak' countries like Greece but equally for an allegedly 'strong' country like Germany.

The bottom-line of the book is twofold. First, there will be no European reform agenda at all unless each country does its own homework. Second, and equally urgent, is a new European reform agenda without which alternative approaches in individual countries will inevitably be suffocated. This message, delivered by the country chapters, is underscored by more general chapters on the prospects of trade union policy in Europe and on current austerity policies and how they interact with the new approaches to economic governance at the EU level. These insights are aimed at providing a better understanding across borders at a time when European rhetoric is being used as a smokescreen for national egoism.

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